89-475 (1)
No. ______

IN THE

Supreme Court of the United States

OCTOBER TERM, 1989

PEAT MARWICK MAIN & CO.,

Petitioner,

—v.—

PHILIP D. ROBERTS, *et al.*,

Respondents.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE NINTH CIRCUIT

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QUESTIONS PRESENTED

1. Whether there exists an implied private right of action for aiding and abetting a violation of Section 10(b) of the Securities Exchange Act of 1934 or Rule 10b-5 promulgated thereunder.

2. Whether the existence of an independent duty to speak is a prerequisite to the imposition of liability for aiding and abetting a violation of Section 10(b) or Rule 10b-5 on the basis of mere silence or inaction.

3. Whether an accounting firm can be held civilly liable for aiding and abetting a violation of Section 10(b) of the Securities Exchange Act or Rule 10b-5 where the only statement concerning the accounting firm in an offering document is the truthful statement that the firm had agreed to perform accounting services in the future.

PARTIES BELOW

Peat, Marwick, Mitchell & Co., now Peat Marwick Main & Co. ("Peat Marwick"), was the defendant/appellee below and is the petitioner in this Court.

Houston Harbaugh, P.C. was also a defendant/appellee below.[1]

Putative class representatives, Philip D. Roberts, Lynn Roberts, Denny Delk, Karen Delk and William J. Freschi were the plaintiffs/appellants below and are the respondents in this Court.

Pursuant to Rule 28.1 of the Rules of this Court, Peat Marwick Main & Co. informs the Court that it is a partnership with no ownership interest held by members of the public.

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1 Other defendants in the underlying action did not join in the appeal to the Ninth Circuit Court of Appeals.

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Petitioner, Peat Marwick Main & Co. ("Peat Marwick") respectfully prays that a writ of certiorari issue to review the decision and judgment of the United States Court of Appeals for the Ninth Circuit in the above-entitled proceeding rendered on September 19, 1988.

OPINIONS BELOW

The decision of the United States Court of Appeals for the Ninth Circuit, review of which is sought, is reported at 857 F.2d 646 and is set forth in the appendix to the Petition beginning at 1a. The denial by the Ninth Circuit of Peat Marwick's Petition for Rehearing With Suggestion for Rehearing En Banc was issued on July 17, 1989, and is set forth in the Appendix at 18a.

The initial stay of its mandate issued by the Ninth Circuit pending the filing of this Petition is dated July 25, 1989 and is set forth in the Appendix at 20a. A further stay of the Ninth Circuit's mandate dated August 14, 1989 is set forth in the Appendix at 21a.

The March 23, 1987 decision of the United States District Court for the Northern District of California granting Peat Marwick's motion for summary judgment as to the claims against it asserting primary liability under Section 10(b) of the Securities Exchange Act of 1934 and for dismissal as to the secondary liability claims which are the subject of this Petition is reported at 670 F. Supp. 1466 and is set forth in the Appendix at 22a.

JURISDICTION

This is an action for alleged violations of the federal securities laws over which the District Court had jurisdiction based on Section 27 of the Securities Exchange Act of 1934, 15 U.S.C. § 78aa (Supp. V 1987), and Section 22 of the Securities Act of 1933, 15 U.S.C. § 77v (Supp. V 1987). The Court of Appeals had jurisdiction to hear the appeal of respondent and the cross-appeal of petitioner based on Rule 54(b), Fed. R. Civ. P., and 28 U.S.C. § 1291 (1982). The opinion and order of the Court of Appeals were entered on September 19, 1988. Petitioner's timely motion for rehearing was denied on July 17, 1989. This Court's jurisdiction is invoked pursuant to 28 U.S.C. § 1254(1) (1982), as amended; the Petition is being timely filed within 90 days of the denial of rehearing.

STATUTORY PROVISIONS INVOLVED

Section 10(b) of the Securities Exchange Act of 1934, 15 U.S.C. § 78j(b) (1982) provides:

> "It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce or of the mails, or of any facility of any national securities exchange—

* * *

"(b) To use or employ, in connection with the purchase or sale of any security registered on a national securities exchange or any security not so registered, any manipulative or deceptive device or contrivance in contravention of such rules and regulations as the Commission may prescribe as necessary or appropriate in the public interest or for the protection of investors."

Rule 10b-5 of the Securities Exchange Commission, 17 C.F.R. § 240.10b-5 (1988), provides:

"It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce, or of the mails or of any facility of any national securities exchange,

"(a) To employ any device, scheme, or artifice to defraud,

"(b) To make any untrue statement of a material fact or to omit to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading, or

"(c) To engage in any act, practice, or course of business which operates or would operate as a fraud or deceit upon any person,

in connection with the purchase or sale of any security."

STATEMENT OF THE CASE

This Petition seeks review of a decision by the United States Court of Appeals for the Ninth Circuit holding that the truthful statement that an accounting firm had agreed to perform accounting services in the future contained in an allegedly misleading offering memorandum, coupled with a conclusory allegation that the firm knew of alleged misstatements in the memorandum, may create a duty to disclose on the part of the accounting firm sufficient to render its silence as to the alleged misstatements actionable as aiding and abetting in connection

with the anti-fraud provisions of Section 10(b) of the Securities Exchange Act of 1934 and Rule 10b-5 promulgated thereunder.

This Petition arises from a complaint filed in the United States District Court for the Northern District of California alleging that over 100 defendants violated various securities laws and other laws by conspiring to defraud the plaintiff class.[2] The plaintiff class is composed of investors in thirty-nine oil and gas limited partnerships sold as potential tax shelters between 1979 and 1983 by three separate partnership groups with different general partners (Complaint ¶ 12).

The price of an interest in the relevant partnerships was $150,000 (Complaint ¶¶ 6-8). Plaintiffs effected the purchase by making a first installment payment of $12,500, simultaneously executing two unconditional promissory notes in the same amount payable in the two succeeding years, and irrevocably agreeing to long-term obligations for the remainder (857 F.2d at 651 (Pet. 12a); Complaint ¶¶ 6-8).

Certain oil technologies assertedly crucial to the partnerships failed to materialize and the investors brought suit under Section 10(b) of the Securities Exchange Act of 1934 and Rule 10b-5, alleging fraud in the sale of the partnerships as securities.

On May 21, 1986, the District Court for the Northern District of California dismissed plaintiffs' Third Amended Complaint with leave to amend to cure pleading deficiencies identified by the court. The court cautioned plaintiffs that, if deficiently pleaded claims remained in the next amended complaint, they would be dismissed with prejudice. *Roberts* v. *Heim*, 670 F. Supp. 1466, 1473 (N.D. Cal. 1987) (Pet. 25a).

In their Fourth Amended Complaint, at issue here, plaintiffs claimed to have made their purchases in reliance on selling memoranda in which the partnerships failed to disclose, *inter alia*, their relationship to the licensors of certain oil recovery

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2 The 152 page Fourth Amended Complaint is set forth in the Appendix at 71a-203a.

technology or the essential worthlessness of that technology (Complaint ¶ 40). The only services Peat Marwick is alleged to have performed were the preparation of audit reports and tax forms for several of the partnerships *after* the plaintiffs purchased their interests and the partnerships were formed (Complaint ¶¶ 6-8, 17). Thus, although the selling memoranda on which plaintiffs claimed to have relied are roughly 300 pages long, the sole reference to Peat Marwick in that document is the statement that "Peat, Marwick, Mitchell & Co., Denver, Colorado has agreed to perform accounting services for the Partnership, including the preparation of tax returns and audited financial statements" (Complaint ¶ 43(b)). It is uncontested that that statement was true.

Although Peat Marwick's services occurred after plaintiffs invested, plaintiffs charged Peat Marwick as a primary violator under Section 10(b) on the basis of its post-investment audit reports and tax forms. Plaintiffs also charged Peat Marwick with aiding and abetting the partnerships' alleged violations of Section 10(b) in connection with the pre-investment selling memoranda because Peat Marwick allegedly had "participated" in preparing those memoranda despite its alleged "knowledge" of the misstatements contained in them.

Plaintiffs premised both their allegations of "knowledge" and "participation" on the one sentence contained in the partnerships' offering memoranda that referred to the fact of Peat Marwick's engagement to perform post-offering services. Plaintiffs asserted that Peat Marwick "knew" that the memoranda were misleading because it had "investigated" the partnerships prior to "consenting to the use of its name."[3] Plaintiffs then reasoned that by virtue of this consent Peat

3 Reference is made in the Complaint to an "investigation of the partnerships' management, as more specifically alleged above" as the basis for this knowledge of falsity (Complaint ¶ 60(b)). The only prior (or subsequent) "specification" consists of the bare allegation that "Peat . . . investigated the management of the partnerships" (Complaint ¶ 43(b)). The allegations relied upon by Plaintiffs below are ¶¶ 6(a), 7(a), 8(a), 17, 43(a), (b) and 60.

Marwick had "participat[ed] in the process by which the confidential memoranda . . . were finalized," (Complaint ¶ 60) thereby "assuming effective control over the contents of the confidential memoranda and the occurrence of the offerings" (Complaint ¶ 43).

In response, Peat Marwick moved for summary judgment as to the claim of primary liability and to dismiss the aiding and abetting claim for failure to state a claim.

The District Court Opinion

On March 23, 1987, the district court granted Peat Marwick's motion in full. It granted summary judgment as to the primary liability claim, holding that plaintiffs could not recover "based on financial reports issued after plaintiffs purchased their units." *Roberts* v. *Heim*, 670 F. Supp. 1466, 1481 (N.D. Cal. 1987) (Pet. 40a).

As to the aiding and abetting claim, the court read the complaint to allege that "Peat, Marwick is liable for aiding and abetting by virtue of its consent to the inclusion of its name in the confidential memoranda read by plaintiffs. . . ." 670 F. Supp. at 1482 (Pet. 41a). The court determined that the three elements of a claim for aiding and abetting a primary fraud under Section 10(b) are "(a) the existence of a primary fraud; (b) actual knowledge by the aider and abettor of the fraud; and (c) 'substantial assistance' in the perpetration of the fraud." 670 F. Supp. at 1481 (Pet. 40a). Noting that the plaintiffs' pleadings rested on the true statement that Peat Marwick would "provide accounting services in the future," the court declined to "expand the scope of § 10(b) liability to encompass professionals whose involvement in the perpetration of the alleged fraud was merely agreeing to provide professional services in the future." 670 F. Supp. at 1482 (Pet. 42a). The court thus concluded that "mere agreement to provide accounting services in the future does not amount to substantial assistance

. . . ," and dismissed plaintiffs' aiding and abetting claim with prejudice. *Id.* (Pet. 42a).[4]

The Opinion of the Court of Appeals

The Court of Appeals affirmed the dismissal on summary judgment of the claims for primary liability against Peat Marwick for essentially the same reasons as the district court, 857 F.2d at 649-652 (Pet. 8a-13a), but it placed a different gloss on the bare allegations of the Complaint, 857 F.2d at 652 (Pet. 13a), and it concluded, with regard to the aiding and abetting claim, that:

> "[t]he investors have pled an independent wrong—a section 10(b) violation by other entities. In addition, investors have alleged that Peat, Marwick knew of the alleged violation but allowed the use of its name in offering memoranda despite that knowledge. These facts may be sufficient to create a duty to disclose in Peat, Marwick."

857 F.2d at 653 (Pet. 14a). It cited the same three part aiding and abetting test set out by the district court, and recognized that some basis for a finding of "duty" was required, but it held that "[t]he secondary violator's duty to disclose may arise from a 'knowing assistance of or participation in a fraudulent scheme.' *Harmsen* [v. *Smith*], 693 F.2d [932,] 944 [(9th Cir. 1982), *cert. denied*, 464 U.S. 822 (1983)] (quoting *Strong* [v. *France*,] 474 F.2d [747,] 752 [(9th Cir. 1973)])." *Id.* (Pet. 14a).

The court explained its holding as follows:

> "Investors can reasonably be expected to assume that an accounting firm would not consent to the use of its name on reports and offering memoranda it knew were fraudu-

4 As to defendant Houston Harbaugh, a law firm, the district court held that, because plaintiffs had "not alleged that Houston Harbaugh was retained for any purpose other than to render an opinion on record title . . . . Houston Harbaugh only had a duty to investigate and report matters of public record in the chain of title which may affect marketability." 670 F. Supp. at 1480 (Pet. 38a). The court dismissed with prejudice plaintiffs' claim against Houston Harbaugh as a principal under Section 10(b).

lent. Thus, it may be reasonable to expect an accountant to disclose fraud in this type of situation, where the accountant's information is superior and the cost to the accountant of disclosure is minimal. *See Rudolph* v. *Arthur Andersen & Co.*, 800 F.2d 1040, 1045 (11th Cir. 1986), *cert. denied*, ____ U.S. ____, 107 S. Ct. 1604, 94 L. Ed. 2d 790 (1987)." *Id.* (Pet. 14a).

The court further held that "[t]he investors' complaint states a cause of action because it alleged that the investors relied on Peat, Marwick's reputation when deciding to invest and that they would not have invested had Peat, Marwick disclosed the alleged fraud. *See Rudolph*, 800 F.2d at 1044-45." *Id.* (Pet. 15a).

The Court of Appeals concluded that the district court thus had "erred in prematurely dismissing the aiding and abetting claim for failure to state a claim." *Id.* (Pet. 15a).[5]

A petition for rehearing and suggestion for rehearing *en banc* was filed on October 3, 1988 and, although the Ninth Circuit panel requested responsive briefing (see Fed. R. App. P. 35(b), 40(a)), it ultimately denied the rehearing without opinion some nine months later on July 17, 1989 (Pet. 18a).[6]

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5 In finding no liability for Houston Harbaugh as a primary violator, the court used a different, five-part test to determine whether the law firm had a duty to disclose information omitted from the title opinion. 857 F.2d at 654 (Pet. 15a-16a).

6 An initial stay of the mandate, pursuant to Fed. R. App. P. 41(b), was issued by the Ninth Circuit on July 25, 1989 (Pet. 20a). A further stay of mandate was granted on August 14, 1989 and remains in effect at the time of the filing of this Petition (Pet. 21a).

REASONS FOR GRANTING THE WRIT

THIS COURT SHOULD REVIEW THE DECISION OF THE NINTH CIRCUIT TO RESOLVE THE PREVIOUSLY RESERVED AND IMPORTANT QUESTION OF WHETHER CIVIL LIABILITY EXISTS FOR AIDING AND ABETTING UNDER SECTION 10(b) OF THE SECURITIES EXCHANGE ACT OF 1934 AND RULE 10b-5 AND, IF SUCH LIABILITY EXISTS, TO RESOLVE THE CONFLICT IN THE CIRCUITS AS TO THE ELEMENTS OF SUCH A CLAIM

1. This Court Should Resolve the Previously Reserved Question of Whether a Civil Cause of Action Exists for Aiding and Abetting a Violation of Section 10(b) of the Securities Exchange Act.

This Court has explicitly reserved the questions of "whether civil liability for aiding and abetting is appropriate" under Section 10(b) and Rule 10b-5 and, if such a basis for liability does exist, what are "the elements necessary to establish such a cause of action." *Ernst & Ernst* v. *Hochfelder*, 425 U.S. 185, 192 n.7 (1976); *see also Herman & MacLean* v. *Huddleston*, 459 U.S. 375, 379 n.5 (1983). This Petition presents an opportunity to resolve both of these reserved questions. It presents these questions in a context in which the particular basis for secondary liability—the asserted failure of the defendant to speak with respect to an alleged fraud which it is alleged to have known about—has occasioned significant differences among the Circuits. The Seventh and, to the extent relevant to this action, Second Circuits explicitly require that an independent duty exist before silence can give rise to liability; the Ninth Circuit, and apparently the Eleventh Circuit, reject such approach (*see* point 2, *infra*).

The decision in this case dramatizes the issue of whether liability may be premised on an aiding and abetting theory. Plaintiff sought recovery against Peat Marwick as a primary violator under Section 10(b). That claim failed not because of any prob-

lem with respect to the standing of plaintiff or some technical flaw in its claim against Peat Marwick. It failed because the essential elements of a claim for liability under Section 10(b) were not met and could not be met on the facts of this case. Thus, the aiding and abetting claim here does not itself satisfy the requisites for a primary claim under Section 10(b); there is no allegation remaining here that Peat Marwick itself engaged in a manipulative or deceptive act.

It is one thing to conclude, as this Court has, that an implied claim under Section 10(b) is appropriate as a supplement to the special and specific provisions for civil liability under Section 11 of the 1933 Act (15 U.S.C § 77k (1982)), to ensure that fraudulent conduct violating the rigorous Section 10(b) standards does not go unremedied. *Herman & MacLean* v. *Huddleston*, 459 U.S. 375 (1983). It is quite another to conclude, however, that the specific "procedural restrictions" applicable to the "express civil remedies in the 1933 Act," *id.* at 383-84, should be subject to circumvention by recourse to a common law based "add-on" to Section 10(b) which does *not* require compliance with all the statutory elements of Section 10(b) itself.[7]

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7 As commentators have noted, there is a tension between this Court's concern about fidelity to Congressional intent as reflected in statutory language (*see, e.g.*, *Touche Ross & Co.* v. *Redington*, 442 U.S. 560, 568 (1979)) and the acceptance of broad implied secondary liability based on "common law" principles with respect to a statutory section where even primary liability is itself a judicial construct. *See* Fischel, *Secondary Liability Under Section 10(b) of the Securities Act of 1934*, 69 Calif. L. Rev. 80 (1981).

Allowing application of the common law aiding and abetting concept to the implied right of action under Section 10(b) or Rule 10b-5 has the effect of expanding the scope of actionable conduct beyond the statutory proscription—a course that has been explicitly and repeatedly rejected by this Court in defining the bounds of primary liability. *Ernst & Ernst* v. *Hochfelder*, 425 U.S. 185 (1976) (interpreting the statutory proscription on "manipulative or deceptive conduct" as limiting the private right of action under Section 10(b) to instances where defendant had the requisite intent to deceive); *Santa Fe Industries, Inc.* v. *Green*, 430 U.S. 462, 473-74 (1977) ("[t]he language of § 10(b) gives no indication that Congress meant to prohibit any conduct not involving manipulation or deception. . . . Thus [a]

The risk is that aiding and abetting liability lacks ties to the mooring that the securities statutes (and, in the case of Rule 10b-5, SEC rules and long-settled case law) provide and can become a vessel dangerously adrift. That problem exists in recognizing any implied right of action; it is even more serious if the right is one imposing secondary liability for conduct which does not itself satisfy the statutorily derived elements of primary liability. That risk of unguided potential liability is well illustrated by the Ninth Circuit decision in this case.

The most recent, comprehensive scholarly work on the issue of Section 10(b) aiding and abetting liability concludes that analysis of the factors set forth by this Court in *Cort* v. *Ash*, 422 U.S. 66 (1975), does not support recognition of an implied private right of action. Bromberg & Lowenfels, *Aiding and Abetting Securities Fraud: A Critical Examination*, 52 Albany L. Rev. 637, 650-61 (1988). That article describes the confused and uncertain state of the law in this area. It concludes, *inter alia*, that, in addition to clarification of specific elements, one important need is resolution by this Court (or Congress) of the "overarching question of whether there is a private cause of action for aiding-abetting" a Section 10(b) violation. *Id.* at 773.

The Courts of Appeals have, in the absence of a definitive resolution by this Court, generally recognized the existence of an implied right of action for aiding and abetting a violation of

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claim of fraud . . . states a cause of action under any part of Rule 10b-5 only if the conduct alleged can be fairly viewed as 'manipulative or deceptive' within the meaning of the statute"); *Chiarella* v. *United States*, 445 U.S. 222, 234-35 (1980) (finding no liability for failure to disclose absent a duty to disclose; the Court stated, "As we have emphasized before, the 1934 Act cannot be read ' "more broadly than its language and the statutory scheme reasonably permit." ' . . . Section 10(b) is aptly described as a catchall provision, but what it catches must be fraud").

The Seventh Circuit took note of this point recently, rejecting an expansive reading of aiding and abetting liability. It noted that such reading (one, as we discuss *infra*, quite akin to that adopted here by the Ninth Circuit) "casts doubt (unnecessary to pursue in this case) on the appropriateness of judicial creativity in borrowing that criminal-law concept for use in securities law." *Latigo Ventures* v. *Laventhol & Horwath*, 876 F.2d 1322, 1327 (7th Cir. 1989).

Section 10(b) or Rule 10b-5. *See, e.g.*, cases collected in Fischel, *supra*, 80 Calif. L. Rev. at 81 n.11; *but cf.*, *Latigo Ventures* v. *Laventhol & Horwath*, *supra*, 876 F.2d at 1327. Both before and after this Court's reservation of the question of the existence of a claim for aiding and abetting in *Hochfelder* and *Huddleston*, the lower federal courts have struggled to apply common law aiding and abetting concepts to conduct statutorily proscribed by Section 10(b) and Rule 10b-5. Federal trial and appellate courts have evolved varying approaches, shaped or altered periodically by decisions of this Court defining and clarifying (i) the bounds of conduct proscribed by Section 10(b) itself, (ii) the analytical approach to determining those bounds, and (iii) the nature of the implied private remedy for violations.

Nowhere is the resulting confusion more apparent than in the variety of approaches to the question of when, if ever, a defendant can be held liable for aiding and abetting a Section 10(b) violation on the basis of its silence or inaction. On this issue, there are important and disturbing differences in the approaches of various Circuits regarding the appropriate nature and role of such a defendant's duty.

The Ninth Circuit's decision in this case presents an opportunity for this Court to determine the underlying questions previously reserved as to the existence *vel non* of aiding and abetting liability and, if answered in the affirmative, to resolve the conflict among the circuits as to the elements of such wholly implied claim. The issues posed are important to the administration of the federal securities laws and in very practical terms to the decisions of investors.

2. The Decision Below Is in Conflict with Decisions of the Seventh and Second Circuit on Whether Silence Can Be Actionable Aiding and Abetting Absent an Independent Duty To Speak

The Second and Seventh Circuit Approach: Silence Is not Actionable Absent an Independent Duty to Speak

Most of the Circuits that have considered the elements of a claim for aiding and abetting have adopted some form of a three part test for liability. As the Second Circuit has stated:

> "The cases generally list three prerequisites to aiding and abetting liability:
>
> "(1) the existence of a securities law violation by the primary (as opposed to the aiding and abetting) party;
>
> "(2) 'knowledge' of this violation on the part of the aider and abettor; and
>
> "(3) 'substantial assistance' by the aider and abettor in the achievement of the primary violation."

IIT v. *Cornfeld*, 619 F.2d 909, 922 (2d Cir. 1980); *see also Ernst & Ernst* v. *Hochfelder*, *supra*, 425 U.S. at 191-92 n.7.

But the Second Circuit has expressed reservations about the utility of that framework generally, *IIT*, 619 F.2d at 922, and has, in the context of a claim of aiding and abetting premised only on silence or inaction, insisted that there be: either (i) an "independent," pre-existing duty to act or disclose or (ii) "clear evidence of the required degree of scienter . . . and a conscious and specific motivation for not acting on the part of an entity with a direct involvement in the transaction." 619 F.2d at 927. It cautions that the three part framework not "obscure the basic proposition that mere bystanders, even if aware of the fraud, cannot be held liable for inaction . . . ." *Id.*

The Seventh Circuit imposes a still more restrictive approach to aiding and abetting liability premised on silence or inaction. It interprets this Court's analyses of Section 10(b) in *Ernst &*

Ernst, *Chiarella*, *Santa Fe*, and *Dirks* v. *SEC*, 463 U.S. 646 (1983), as limiting imposition of Section 10(b) liability to defendants who have *themselves* committed a proscribed manipulative or deceptive act. It, therefore, considers the tripartite test to provide merely "*additional requirements*" for aider and abettor liability in instances where there is a sufficient pleading or showing that a defendant itself committed a proscribed act but not that it has participated in a purchase or sale transaction. *Barker* v. *Henderson, Franklin, Starnes & Holt*, 797 F.2d 490, 495 (7th Cir. 1986). *See Latigo Ventures* v. *Laventhol & Horwath*, *supra*, 876 F.2d at 1326-27.

Consistent with this more restrictive approach to aiding and abetting liability generally, the Seventh Circuit focuses on the presence or absence of an independent, pre-existing duty to disclose for purposes of making what it views as the *threshold* determination of whether the alleged aider/abettor's silence can reasonably be characterized as deceptive or manipulative. *Id.* 495-96; *Schlifke* v. *Seafirst Corp.*, 866 F.2d 935, 948 (7th Cir. 1989). The Seventh Circuit requires that there be an independent duty to disclose which "must come from a fiduciary relation *outside* the securities laws" before aiding and abetting a Section 10(b) violation can be found on the basis of silence or inaction. *Barker* v. *Henderson, Franklin, Starnes & Holt*, *supra*, 797 F.2d at 496; *Schlifke* v. *Seafirst Corp.*, *supra*, 866 F.2d at 948 (emphasis added).[8]

That Circuit explained its approach in the following terms:

> "When the nature of the offense is a failure to 'blow the whistle,' the defendant must have a duty to blow the whistle. *And this duty does not come from § 10(b) or Rule 10b-5; if it did the inquiry would be circular.* The duty must come from a fiduciary relation outside securities law.

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8 Although a fiduciary duty was pleaded as to other defendants here (Complaint ¶¶ 55(c), (d), (e), (i), (j), (k); 56(a)-(f); 57-59), no such allegation was advanced as to Peat Marwick.

Dirks, 463 U.S. at 653-64, 103 S. Ct. at 3260-61; *Chiarella*, 445 U.S. at 227-35, 100 S. Ct. at 1114-18."

Barker v. *Henderson, Franklin, Starnes & Holt*, *supra*, 797 F.2d at 496 (emphasis added).

The Ninth Circuit Approach: Silence Is Actionable, Even Without an Independent Duty

The decision below, by contrast, while accepting the requirement that *some* duty must be found to render silence actionable, rejects any requirement of an *independent* duty. Instead it holds, drawing upon (and expanding) prior Ninth Circuit precedent, that the "secondary violator's duty to disclose may arise from a 'knowing assistance of or participation in a fraudulent scheme.' " 857 F.2d at 653 (Pet. 14a).

This is the opposite of the *independent* duty requirement recognized by the Second and Seventh Circuit and illustrates the very "circularity" the Seventh Circuit decried. Far from prescribing an *additional* requirement, the Ninth Circuit simply collapses the duty requirement into the underlying definition of "substantial assistance." Indeed, elsewhere in *Roberts*, the Ninth Circuit states that "sufficient *knowledge*" was alleged "to create a possible duty to disclose information concerning the alleged fraud." 857 F.2d at 653 (Pet. 14a) (emphasis added). Again, it simply treats duty as being identical with one or another aspect of the three part test, although it is inconsistent in identifying which aspect. Thus, the Ninth Circuit withholds the *additional* protection against liability for silence or inaction which other Circuits expressly recognize.

The effect here is to allow the Ninth Circuit to sustain a claim which other Circuits clearly would reject. Thus it was held here:

> "The investors have pled an independent wrong—a section 10(b) violation by other entities. In addition, investors have alleged that Peat, Marwick knew of the alleged violation but allowed the use of its name in offering memoranda despite that knowledge. These facts may be sufficient to create a duty to disclose in Peat, Marwick.

> Investors can reasonably be expected to assume that an accounting firm would not consent to use of its name on reports and offering memoranda it knew were fraudulent. Thus, it may be reasonable to expect an accountant to disclose fraud in this type of situation, where the accountant's information is superior and the cost to the accountant of disclosure is minimal. *See Rudolph* v. *Arthur Andersen & Co.*, 800 F.2d 1040, 1045 (11th Cir. 1986), *cert. denied*, ____ U.S. ____, 107 S. Ct. 1604, 94 L. Ed. 2d 790 (1987)."

857 F.2d at 653 (Pet. 14a).

The Eleventh Circuit in *Rudolph*, the decision primarily relied upon in *Roberts*, follows a somewhat similar approach to that adopted by the Ninth Circuit. In *Rudolph*, the Eleventh Circuit held that both primary and aiding and abetting liability could be found on the basis of an accounting firm's failure to disclose alleged fraud where the complaint alleges that the accounting firm allowed its prior, undisputedly accurate, audit report to appear in a placement memorandum which it knew or should have known contained material misrepresentations unrelated to the audit report. *Rudolph* v. *Arthur Andersen & Co.*, 800 F.2d 1040, 1044-46 (11th Cir. 1986), *cert. denied*, 480 U.S. 946 (1987). Even *Rudolph*, of course, imposes the possibility of liability only with respect to an auditor who has already issued a report—not one, as here, who has yet to conduct an audit, let alone issue a report. But its analysis of duty reflects many of the same problems as are at issue here.

The Conflict Among the Circuits Promotes Confusion and Forum Shopping

Both the reasoning of the Ninth Circuit and Eleventh Circuit and the result reached in *Roberts* and *Rudolph* were explicitly rejected by the Seventh Circuit recently in *Latigo Ventures* v. *Laventhol & Horwath*, *supra*, where the complaint sought to impose liability on an accounting firm for failure to disclose a fraud where the firm had not itself made any misstatement:

"It is not the law that whenever an accountant discovers that his client is in financial trouble he must blow the whistle on the client for the protection of investors—so that Laventhol & Horwath should have taken out an advertisement in the *Wall Street Journal* stating that it had just discovered that its client Xonics, Inc. was losing money, rather than waiting to report this in the next audit report. That would be an extreme theory of accountants' liability, and it is one we decline to embrace as an interpretation of the common law of Illinois, having in previous cases specifically rejected it as a possible theory of Rule 10b-5 aider and abettor liability. *Barker* v. *Henderson, Franklin, Starnes & Holt*, 797 F.2d 490, 496-97 (7th Cir. 1986); *see also LHLC Corp.* v. *Cluett Peabody & Co.*, *supra*, 842 F.2d at 932-33; *Abell* v. *Potomac Ins. Co.*, 858 F.2d 1104, 1123-26 (5th Cir. 1988). There is no actionable nondisclosure without a duty to disclose, and in deciding whether there should be such a duty a court should attend to the practical consequences. Relations of trust and confidence between accountant and client would be destroyed if the accountant were duty-bound to make continuous public disclosure of all the client's financial adversities. And the costs of auditing would skyrocket to compensate the accounting profession for the enormous expansion in potential liability, not to mention the increase in the costs of publication.

"Against all this it can be argued that cases in other circuits, expansively construing the judge-made concept of aiding and abetting a Rule 10b-5 violation, have held that an accountant cannot 'stand . . . idly by while knowing one's good name is being used to perpetrate a fraud,' *Rudolph* v. *Arthur Andersen & Co.*, 800 F.2d 1040, 1044 (11th Cir. 1986); *see also Roberts* v. *Peat Marwick Mitchell & Co.*, 857 F.2d 646, 652 (9th Cir. 1988). Insofar as these cases are inconsistent with our decisions rejecting

aider and abettor liability on a whistleblower theory, we respectfully decline to follow them."[9]

876 F.2d at 1327.

The existence of such divergent analytical approaches among the Circuit Courts in applying aiding and abetting concepts to Section 10(b) and Rule 10b-5 actions tends to create confusion, inconsistency and lack of predictability in application of an important aspect of the federal securities laws. In applying the common law concept of aiding and abetting to conduct statutorily proscribed by Section 10(b) and Rule 10b-5 without explicit guidance from this Court, the Circuit Courts have developed formulations so different that they have the anomalous effect of making identical conduct by "secondary" defendants violative of the statute in one Circuit and beyond the purview of the statutory proscription in another.

The conflict is not one of words, but of outcomes. Thus, for example, an accountant in Illinois who allegedly had knowledge of misstatements, but communicated to purchasers only after their investments, "had no obligation to blow the whistle." *LHLC Corp.* v. *Cluett, Peabody & Co.*, 842 F.2d 928, 933 (7th Cir. 1988), *cert. denied*, 109 S. Ct. 311 (1988). A New York accountant who allegedly had knowledge of misstatements in a prospectus, but did not reveal what it knew while including its own accurate report in the prospectus, had "no independent duty to see to the correction of portions of the prospectus other than the financial statement it prepared." *IIT* v. *Cornfeld*, *supra*, 619 F.2d at 927. And a lender in Texas who allegedly had knowledge of misstatements, and included loan documents in an investor package but did not disclose what it knew, did not "cloak the principal defendants in an aura of respectability or reliability," so had no liability. *Bane* v. *Sigmundr Exploration Corp.*, 848 F.2d 579, 582 (5th Cir. 1988).

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9 The Seventh Circuit noted that the case before it was distinguishable from both *Roberts* and *Rudolph* in that there was no specific claim of reliance on the name of the auditor in the decision to purchase. As the quoted passage illustrates, however, the decision makes plain the fundamental conflict in approach to aiding and abetting liability which exists between the Circuits.

The accountants in *Rudolph* did no more than the professionals in those cases, and the accountants here did substantially less. Yet, in the Ninth and Eleventh Circuits, they may be subjected to liability.

Federal law should be applied uniformly, and outcomes in federal securities cases should not turn on the court in which a party happens to find itself. Indeed, the split in authority encourages forum shopping, which is not particularly difficult in large securities cases. *See, e.g., Somerville* v. *Major Exploration Inc.*, 576 F. Supp. 902, 908 (S.D.N.Y. 1983) (securities laws give plaintiffs "the widest possible choice of forums").[10] Review to resolve this conflict is warranted.

3. The Ninth Circuit's Approach Is Inconsistent with this Court's Analysis in *Chiarella* and *Dirks* and Warrants Review on this Basis as Well.

The Seventh Circuit's conclusion that the decisions of this Court in *Ernst & Ernst*, *Chiarella*, *Dirks* and *Santa Fe* call for a restriction of the potential scope of aiding and abetting liability under Section 10(b) to those who themselves committed manipulative or deceptive acts highlights the need for clarification on this issue and the arguable conflict between the Ninth Circuit's decision and this Court's prior rulings. One need not accept the Seventh Circuit's interpretation of this broader question, however, in order to conclude that its requirement that there must exist an independent duty to disclose before aider/abettor liability may be imposed under Section 10(b) for mere silence is flatly at variance with the Ninth Circuit's approach in this case, and is more in keeping with this Court's prior rulings.

Only an independent, recognized duty to speak under certain circumstances gives meaning and (potentially deceptive) content to inaction or failure to speak. Absent such a duty, silence is neutral; it may not inform, but neither does it deceive or assist in deception. Only the justified expectation of action or disclo-

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10 Indeed, here, the partnerships were centered in Wichita, New York and Denver, and the accountants were in Denver. Yet, the case was brought in California, subjecting Peat Marwick to the Ninth Circuit's expansive approach to aiding and abetting liability.

sure upon the occurrence of a certain event can imbue non-action or non-disclosure with meaning. In other words, silence cannot be deceptive or assist in deception unless it is communicative and, absent a specific duty to speak, silence cannot be communicative.

This basic principle was recognized by this Court in *Chiarella* v. *United States*. Defendant Chiarella gained information about impending takeovers through his employment at a financial printer hired by the acquiring corporations. He then purchased securities of various target corporations without disclosing this information to the sellers. Reversing the Second Circuit's affirmance of Chiarella's conviction, this Court stated:

> "[S]ilence in connection with the purchase or sale of securities may operate as a fraud actionable under § 10(b) despite the absence of statutory language or legislative history specifically addressing the legality of nondisclosure. But such liability is premised upon a duty to disclose arising from a relationship of trust and confidence between parties to a transaction."
>
> * * *
>
> "When an allegation of fraud is based upon nondisclosure, there can be no fraud absent a duty to speak."

445 U.S. at 230, 235. *See also Basic Inc.* v. *Levinson*, 108 S. Ct. 978, 987 n.17 (1988) (to be officially reported at 485 U.S. 224):

> "To be actionable, of course, a statement must also be misleading. Silence, absent a duty to disclose, is not misleading under Rule 10b-5."

In *Dirks* v. *SEC*, *supra*, this Court strongly affirmed the *Chiarella* analysis. Dirks, an officer of a broker-dealer firm, learned of fraud in the practices of Equity Funding of America. Without disclosing the fraud to the governing authorities, Dirks informed certain investors of the fraud, who in turn sold their holdings. As a result, the SEC asserted that Dirks had

violated Section 17(a) (15 U.S.C. § 77q(a) (1982)), the anti-fraud analogue to Section 10(b) under the Securities Act of 1933.

Rejecting the SEC's position, this Court held that Dirks did not violate Section 17(a), because he was under no duty to disclose his knowledge of the fraud. The Court "reaffirm[ed]" *Chiarella's* holding that " '[a] duty [to disclose] arises from the relationship between parties . . . and not merely from one's ability to acquire information because of his position in the market.' " 463 U.S. at 657-58 (quoting *Chiarella*, 445 U.S. at 231-32 n.14).

The Ninth Circuit's formulation, as set out in *Roberts*, is a departure from these basic principles in that it assumes that the nature and extent of an alleged aider and abettor's involvement with, or participation in, the alleged underlying fraud can themselves give rise to an inferred duty to disclose, the breach of which may be viewed as "substantial assistance" to the primary wrong. In so holding, the Ninth Circuit fails to recognize that some independent duty to speak or act must be present to provide the expectation of disclosure or action required to render silence or inaction communicative. This duty may arise from the relationship between the parties or because the aider and abettor has said or implied that it will speak or act under certain circumstances. It does not, however, depend on the degree of the alleged aider and abettor's participation in the alleged underlying fraud.

While the degree of affirmative participation may have independent relevance to a determination of whether one's actions have substantially assisted a fraud, it has nothing to do with whether one's *inaction* or *silence* can be communicative, has deceived anyone, or has assisted in bringing about the manipulation or deception. Rather, the answers to these questions depend on the existence or non-existence of an independent duty to speak running from the alleged aider and abettor to the allegedly injured party.

The Ninth Circuit's analysis dispenses with any requirement of independent duty and is premised on a flawed interpretation

of this Court's decisions. The analysis of the Ninth Circuit with respect to silence is all the more flawed because it does recognize the obligation to find an independent duty to disclose in a claim for *primary* liability where the alleged misconduct consists of inaction or silence. Indeed, it applied something like that test here in determining that the law firm, Houston Harbaugh, could not be liable as a primary violator. 857 F.2d at 653 (Pet. 15a-16a). Ironically, in determining the reach of *secondary* liability it declined to apply this more rigorous standard.

Further, the Ninth Circuit concludes that the duty of disclosure may arise from the alleged fact that "the accountant's information is superior and the cost to the accountant of disclosure is minimal." 857 F.2d at 653 (Pet. 15a-16a) (citing *Rudolph*, *supra*, 800 F.2d at 1045).[11] But such analysis is directly at odds with this Court's holdings in *Dirks* v. *SEC*, *supra*, 463 U.S. 657 and *Chiarella* v. *United States*, *supra*, 445 U.S. at 233. *See also* Brennan, J., concurring in *Chiarella*, 445 U.S. at 238-39. As the Court stated in *Chiarella*, "When an allegation of fraud is based upon nondisclosure there can be no fraud absent a duty to speak. We hold that a duty to disclose under § 10(b) does not arise from the mere possession of nonpublic market information." *Chiarella*, 445 U.S. at 235.

The Ninth Circuit in its opinion did not recognize this principle. Nor did its bland assessment of the cost of disclosure as "minimal" take account of the practical costs to the auditor (or other professional) or to the marketplace generally of imposing potential (and potentially unlimited) liability for non-disclosure absent an independent duty to disclose. The Seventh Circuit's opinion in *Latigo Ventures* v. *Laventhol & Horwath*, *supra*, 876

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11 This explanation can be traced back to *Brennan* v. *Midwestern United Life Insurance Co.*, 259 F. Supp. 673, 681 (N.D. Ind. 1966). This explanation of the origins of a supposed duty is of questionable validity in view of this Court's subsequent decisions in *Chiarella* and *Dirks*, rejecting the notion that superior knowledge alone gives rise to a duty to disclose. In light of the seminal character of the *Brennan* decision with respect to aiding and abetting liability (*see Hochfelder*, *supra*, 425 U.S. at 191-92 n.7), the subsequent rejection of its duty formulation raises questions about the overall viability of the aiding and abetting theory.

F.2d at 1327, rejecting the facile duty analysis engaged in by the Ninth Circuit, makes evident the more than "minimal" costs at issue.

4. The Importance of the Issues Presented: The Ninth Circuit's Approach Undermines the Current Federal Statutory Disclosure Scheme, Confuses Investors and Disrupts the Provision of Accounting and Other Professional Services in the Investment Context.

From an investor's perspective, the important function performed by certified public accountants is the rendering of opinions with respect to the financial statements of corporate and other business entities. In recognition of this fact, a detailed system of rules, principles, standards and requirements governs and assures a degree of uniformity with respect to the provision of these essential services. Because this statutory and regulatory scheme exists, accountants know the services they are expected to perform, clients and investors know what investigation has been made of a company's financial status, and reports on financial statements by a firm of certified public accountants have a recognized and consistent meaning.[12]

Until the *Rudolph* and, even more threateningly, the *Roberts* decision at issue here, the courts had been uniform in rejecting liability premised on an accountant's failure to make disclosure with respect to matters it had not reported upon.[13]

Indeed, the Ninth Circuit had itself recognized as much in its earlier decision in *Wessel* v. *Buhler*, 437 F.2d 279 (9th Cir. 1971), where plaintiff sought to hold an accountant liable for an issuer's misuse of financial data previously prepared by the auditor. In an opinion frequently cited with approval by other courts, that decision held:

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12 In *United States* v. *Arthur Young & Co.*, 465 U.S. 805 (1984), a case not involving the securities laws, this Court in discussing its concept of the role of accountants focused on the accountants' "certifying [of] public *reports*." *Id.* at 817-18 (emphasis added). Thus, in this context too, it was the reporting function which was seen as defining the accountants' role.

13 See fn. 14, *infra*.

"There is not a scrap of authority supporting this extraordinary theory of Rule 10b-5 liability, and we will not supply any in this case.

"We find nothing in Rule 10b-5 that purports to impose liability on anyone whose conduct consists solely of inaction. On the contrary, the only subsection that has any reference to an omission, as distinguished from affirmative action, is subsection (2) providing that it is unlawful 'to omit to state a material fact necessary in order to make the statements made . . . not misleading,' *i.e.*, an omission occurring as part of an affirmative statement. (*See Brennan* v. *Midwestern United Life Insurance Co.*, 417 F.2d 147, 154-155 (7th Cir. 1969).) We perceive no reason, consonant with the congressional purpose in enacting the Securities and Exchange Act [sic] of 1934, thus to expand Rule 10b-5 liability. (*Cf. SEC* v. *Texas Gulf Sulphur Co.*, *supra*, 401 F.2d at 866-868 (J. Friendly, concurring specially).) *On the contrary, the exposure of independent accountants and others to such vistas of liability, limited only by the ingenuity of investors and their counsel, would lead to serious mischief.*"

Id. at 283 (emphasis added).

Until *Roberts* (foreshadowed perhaps by *Rudolph*), no case had held that the mere use of an accountant's or other professional's name in a neutral, truthful representation that services would be performed by it in the future could give rise to liability premised on reliance on the professional's reputation. Indeed, the general rule is, as stated by Judge Friendly in *IIT* v. *Cornfeld*, *supra*, 619 F.2d at 927, that even where an accountant makes a representation in a prospectus, the accountant "[has] no . . . duty to see to the correction of portions of the prospectus other than the financial statement it prepared." (Emphasis added.) *And see*, *e.g.*, *LHLC Corp.* v. *Cluett, Peabody & Co.*, *supra*, 842 F.2d at 933 (in affirming dismissal of an aiding and abetting claim against an accounting firm which allegedly reviewed a fraudulent estimate in selling documents, the court stated: "[The accountant] was answerable only for what it com-

municated to [plaintiff], and it did not communicate with [plaintiff] until after [plaintiff's investment]").[14]

The Ninth Circuit's current approach threatens to undermine the understanding shared by both the courts and investors that an accountant acts only through its reports.[15] *Roberts*, unless reviewed and rejected by this Court, is likely to be interpreted by investors (until some later review by this Court) as providing them with assurance that the mere mention of a reputable auditor in a prospectus or offering memorandum can be taken as an assurance that all is well. An assumption that the auditor has performed some undetermined investigation (presumably short of that required to issue a report) will be encouraged. Instead of looking to the substance of the disclosure required by the Securities Acts, investors will be encouraged to look to the mere mention of a reputable professional coming on the scene. This is a reliance without support in the way the audit function actu-

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14 *See also Zoelsch* v. *Arthur Andersen & Co.*, 824 F.2d 27, 34-36 (D.C. Cir. 1987); *Barker* v. *Henderson, Franklin, Starnes & Holt, supra*; *Pegasus Fund, Inc.* v. *Laraneta*, 617 F.2d 1335, 1340 (9th Cir. 1980) ("the relationship of an auditor to the firm it audits creates a narrow duty of disclosure"); *Robin* v. *Doctors Officenters Corp.*, 686 F. Supp. 199, 207-08 (N.D. Ill. 1988) (accountant did not aid and abet fraud by consenting to inclusion of an accurate report in a prospectus which was allegedly misleading for other reasons); *In re Gas Reclamation, Inc. Securities Litigation*, 659 F. Supp. 493, 504-06 (S.D.N.Y. 1987); *In re AM International, Inc. Securities Litigation*, 606 F. Supp. 600, 606-07 (S.D.N.Y. 1985); *Beck* v. *Cantor, Fitzgerald & Co.*, 621 F. Supp. 1547 (N.D. Ill. 1985); *Mendelsohn* v. *Capital Underwriters, Inc.*, 490 F. Supp. 1069, 1083 (N.D. Cal. 1979); *Gold* v. *DCL Inc.*, 399 F. Supp. 1123, 1125-28 (S.D.N.Y. 1973).

15 Similar understandings apply as to other professions as well. *See, e.g.*, *Bane* v. *Sigmundr Exploration Corp.*, *supra*, 848 F.2d at 581-82 (rejecting the notion that inclusion of a bank's standard loan document in an offering proposal should be interpreted to "cloak the principal defendants in an aura of respectability and reliability," so as to support liability for an aiding and abetting violation under 10b-5); *see also National Union Fire Insurance Co.* v. *Turtur*, [1987-88] Fed. Sec. L. Rep. (CCH) ¶ 93,765 at 98,591 (S.D.N.Y. 1988) (insurance company); *Schlifke* v. *Seafirst Corp.*, [1987] Fed. Sec. L. Rep. (CCH) ¶ 93,107 at 95,443 (N.D. Ill. 1987) (lender-bank); *Seattle-First National Bank* v. *Carlstedt*, 678 F. Supp. 1543, 1549 (W.D. Okla. 1987) (lender-bank); *Delany* v. *Blunt, Ellis & Loewi*, 631 F. Supp. 175, 180 (N.D. Ill. 1986) (lender-bank). These too are undermined by *Roberts*.

ally works. It frustrates the intent of the securities laws that the investor avail himself of the actual disclosure that is made. *See Basic Inc.* v. *Levinson*, *supra*, 108 S. Ct. at 997 (White, J., concurring in part and dissenting in part).

And the Ninth Circuit's approach in *Roberts* threatens to render accountants and other professionals liable as a matter of status, not substantive conduct. This approach serves neither the investing public nor professionals involved in the securities industry. If, indeed, a newly hired accountant who has performed no auditing services but is mentioned in a disclosure document is found to have a duty to disclose fraud or irregularities with respect to its new client, the pressure to conduct a "pre-audit-audit" of undetermined scope is plain to the prudent accountant, and other professionals will draw similar lessons. It is no overstatement to say that the ruling of the Ninth Circuit in this case would, as this Court sought to avoid in *Hochfelder*, *supra*, "extend to new frontiers the 'hazards' of rendering expert advice under the Acts, raising serious policy questions not yet addressed by Congress." 425 U.S. at 216 n.33. In that case, the Court was concerned about such expansion in terms of advice actually given; the concern must be magnified here, where the theory of liability is premised on the failure to speak before any advice is ever given or any report ever rendered.

Concern about the impact in terms of cost and time with respect to complaints that ultimately prove frivolous has, in the past, led this Court to place some restrictions on even primary liability under Section 10(b) lest "vexatious litigation" plague the system. *See Blue Chip Stamps* v. *Manor Drug Stores*, 421 U.S. 723, 740 (1975). As the Court noted in *Blue Chip Stamps*,

> "[I]n the field of federal securities laws governing disclosure of information even a complaint which by objective standards may have very little chance of success at trial has a settlement value to the plaintiff out of any proportion to its prospect of success at trial so long as he may prevent the

suit from being resolved against him by dismissal or summary judgment."

Id.

For these reasons, the important legal issues concerning the interpretation of the federal securities laws posed by this Petition are also of enormous practical significance, not only to accountants, but to all professionals, as well as their clients and the investment community as a whole.

CONCLUSION

For the foregoing reasons this petition for a writ of *certiorari* should be granted.

Dated: New York, New York
September 22, 1989

Respectfully submitted,

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APPENDIX

FOR PUBLICATION

UNITED STATES COURT OF APPEALS

FOR THE NINTH CIRCUIT

Nos. 87-2106; 87-2128; 87-2278

D.C. No. CV-84-8069-TEH

PHILLIP D. ROBERTS; LYNN ROBERTS; DENNY DELK; KAREN DELK; WILLIAM J. FRESCHI, on behalf of themselves and all others similarly situated,

Plaintiffs/Appellants/ Cross-Appellees,

—v.—

PEAT, MARWICK, MITCHELL & CO.,

Defendant/Appellee/ Cross-Appellant,

—and—

HOUSTON HARBAUGH, P.C.,

Defendant/Appellee.

Appeal from the United States District Court
for the Northern District of California
Thelton E. Henderson, District Judge, Presiding

Argued and Submitted
April 15, 1988—San Francisco, California

Filed September 19, 1988

Before:

MARY M. SCHROEDER* and ROBERT BOOCHEVER, *Circuit Judges*, and ALBERT LEE STEPHENS,** *District Judge.*

OPINION

Per Curiam

SUMMARY

Securities/Courts and Procedure

The court affirmed in part, reversed in part, and remanded, holding, inter alia, that investor's subsequent payments on a promissory note to purchase securities were not separate purchases under § 3(a) of the Securities and Exchange Act of 1934 and that accordingly, the investors could not sustain a fraud claim under § 10(b) of the Exchange Act against certain auditors because they had not read the audit reports until after they had made their initial subscription payments and had executed the subscription, promissory note, and partnership agreements.

Appellant Phillip Roberts and other plaintiffs are a class of investors who purchased interests in limited partnerships offered by an array of individuals and corporate entities. The partnerships were organized to produce oil and gas through oil recovery technology and to serve as tax shelters. The investors entered into an agreement to pay an initial subscription cost, two short-term promissory note payments for each of the immediately subsequent years, and the remaining amount due in installments due the tenth, eleventh, and twelfth years. Within three years of buying into the partnerships, the oil technologies failed to materialize. Thereafter, the investors sued

* Judge Schroeder was drawn to replace Judge Anderson who died on April 16, 1988.

** Honorable Albert Lee Stephens, Jr., Senior United States District Judge for the Central District of California, sitting by designation.

under § 10(b) of the Exchange Act [15 U.S.C. § 78j(b) and Rule 10b-5 of the Securities Exchange Commission. The complaint against appellee Peat, Marwick, Mitchell & Co. alleged that Peat, Marwick as auditors for the partnership knew or should have known that the partnerships amounted to a scheme to defraud and that Peat, Marwick aided and abetted a § 10(b) violation by participating in the partnership's offering of memoranda containing false and misleading statements. The district court granted summary judgment to Peat, Marwick on the ground that the investors could not have relied on the alleged false statements at the time that they purchased the securities because the reports had not been prepared or read by the investors until after they had made their initial subscription payments. On appeal, the investors contended that each payment on the short-term notes constituted a separate purchase of the securities.

[1] To prevail on a cause of action for violation of § 10(b) and Rule 10b-5, the investors must establish fraud in connection with the purchase or sale of any security. This requires a causal relationship with the fraud and the resulting injury. [2] Section 3(a) of the 1934 Act defines purchase to include "any contract to buy, purchase, or otherwise acquire," and defines sale to include "any contract to sell or otherwise dispose of." [3] In this case, the investors' terms and commitments were unconditional in the subscription, promissory note, and partnership agreements. Accordingly, they were required to pay the promissory notes. [4] Accordingly, because the alleged fraud occurred after the investors made their subscription agreements with the partnerships, their subsequent payments did not constitute separate purchase of securities. Therefore, their alleged injury is not connected to the purchase or sale of a security under § 10(b). [5] However, the defendants may be liable under § 10(b) and Rule 10b-5 for aiding and abetting based on their silence if they had a duty to disclose knowledge that would be material to the investors. [6] The investors stated a cause of action for aiding and abetting because they alleged that Peat, Marwick knew of the alleged violation and that they allowed the use of its name in offering information to investors despite that knowledge. In addition, they alleged that they relied on

Peat, Marwick's reputation when deciding to invest and that they would not have invested had Peat, Marwick disclosed the alleged fraud. [7] However, investors' complaint against the law firm that prepared title opinions for the property purchased by some of the partnerships must fail because investors make no claim against the preparation of the titles. The law firm's duty was only to determine marketability and it had no duty to disclose information not relevant to marketability. [8] Investors are not entitled to sanctions under F.R.Civ.P., Rule 11 against Peat, Marwick in retaliation for their having moved erroneously for sanctions under Rule 11.

COUNSEL

Solomon B. Cera, David B. Gold, a Professional Law Corporation, San Francisco, California, for the plaintiffs-appellants-cross-appellees.

Richard N. Patterson, McCutchen, Douglas, Brown & Enersen, San Francisco, California, for the defendant-appellee-cross-appellant.

James J. Corbelli, Lillick, McHose & Charles, San Francisco, California, for the defendant-appellee.

OPINION

PER CURIAM:

OVERVIEW

Plaintiffs are a class of investors who purchased interests in limited partnerships offered by an array of individuals and corporate entities. Defendants are accountants and attorneys who provided professional services to the partnerships. When the value of the partnerships failed to materialize, the investors brought suit under federal and state securities laws. The district court granted summary judgment and dismissal for the defendants on the federal securities claims, dismissed the investors'

remaining state claims, and denied cross motions for sanctions. The investors appeal the summary judgment and dismissal of the federal claims, and both parties appeal denial of their respective motions for sanctions. We affirm in part, reverse in part, and remand.

FACTS AND PROCEEDINGS BELOW

Between 1980 and 1982 the investors purchased numerous shares in limited partnerships. The partnerships were organized to produce oil and gas through oil recovery technology which increased production of otherwise nonproductive oil-bearing property and were also to serve as tax shelters. The partnerships were organized and sold by a number of corporate entities and individuals, including Werner Heim as an individual. Some of these entities served as general partners in the partnerships. The defendants include the accounting firm of Peat, Marwick, Mitchell & Co. ("Peat, Marwick") and the law firm of Houston Harbaugh, P.C., ("Houston Harbaugh"), each of which rendered professional services to the partnerships.[1] Peat, Marwick provided accounting services to the partnerships and issued audit reports. Houston Harbaugh prepared title opinions on real properties purchased by the partnerships.

The total price of a partnership unit was $150,000. This commitment consisted of $12,500 paid in cash upon initial subscription, two $12,500 payments on short-term promissory notes for each year of the two immediately subsequent years, and $112,500 payable in three installments due in the subsequent tenth, eleventh and twelfth years. Within three years of buying into the partnership, the oil technologies failed to materialize and the investors brought suit under the Securities Exchange Act of 1934, section 10(b) and Rule 10b-5, alleging fraud in the sale of the partnerships as securities.

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1 Many additional defendants, including the general partners, were named in the original complaint but are not parties here. Peat, Marwick, Mitchell & Co. and Houston Harbaugh, P.C., are the only defendants involved in this appeal. The plaintiffs consist of those individual investors who purchased an interest in the limited partnerships. The district court provisionally certified the suit as a class action.

The complaint against Peat, Marwick alleged: (a) the oil recovery technologies were unproven and, as a result, the partnerships never had the value represented, (b) the limited partnerships purchased mineral properties from Werner Heim and his corporate alter egos at over-inflated prices, and (c) the partnerships amounted to a scheme to defraud which Peat, Marwick knew of or should have been aware of. An additional claim alleged Peat, Marwick aided and abetted a section 10(b) violation by participating in partnership offering memoranda which contained false and misleading statements. With respect to Houston Harbaugh, the investors alleged: (a) it prepared false and misleading title opinions to some of the partnership properties, and (b) it knew and failed to disclose or recklessly disregarded the fact that the properties were transferred between various entities to conceal Heim's previous ownership, and that the properties were not acquired in arms-length transactions. Finally, the investors asked for Fed. R. Civ. P. 11 sanctions in response to Peat, Marwick's own motion for Rule 11 sanctions.

The district court granted summary judgment in favor of Peat, Marwick on the section 10(b) claim, finding it did not become involved with the transaction until after the investors made their initial partnership contributions, and that the installment payments on the short-term promissory notes were not separate investment decisions for which liability could attach for fraud in the sale of a security. On the aiding and abetting allegation, the district court dismissed with prejudice for failure to state a claim. The district court also dismissed with prejudice the separate section 10(b) claim against Houston Harbaugh, finding the title opinions were correct as a matter of law because they accurately identified the entity holding title to the property. Finally, both Peat, Marwick's motion and the investors' cross-motion for Rule 11 sanctions were denied.[2]

The investors appeal summary judgment on the main claims and the dismissals of their section 10(b) and aiding and abetting claims. Both Peat, Marwick and the investors appeal denial of their respective motions for sanctions.

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2 Other claims were also asserted and many other theories of liability were employed but these limited claims were the claims appealed.

ANALYSIS

1. Separate Purchases

The investors allege they read and relied on audit reports and Form K-1 tax returns prepared by Peat, Marwick prior to making payments on their short-term promissory notes. The reports were alleged to be materially false and misleading in violation of section 10(b) of the Exchange Act because they failed to disclose that the represented tax benefits would not be available in light of: (1) the dependent relationship between the technology licensor and the partnership, (2) the partnerships' lack of profit motive, (3) the long-term obligations' failure to qualify for tax deductions, (4) the unproven and hence overvalued technology, and (5) the commingling of partnership funds and assets. In their depositions, the investors stated that they relied on the documents prepared by Peat, Marwick before making payments to the partnerships under the short-term promissory notes. They also stated that had they known of the alleged section 10(b) violations, they would not have made the subsequent payments on their note obligations. However, the investors acknowledged that the reports by Peat, Marwick alleged to have been false and misleading were not prepared and read by them until after they made their initial subscription payments and after they executed the subscription, promissory note and partnership agreements.

The investors argue that each payment on the short-term notes constituted a separate purchase of securities. This argument is essential to the investors' case because by acknowledging that Peat, Marwick's reports and tax returns were not involved in the partnerships when they initially agreed to invest, they cannot establish fraud "in the purchase." *Securities Investor Protection Corp. v. Vigman*, 803 F.2d 1513, 1516-17 (9th Cir. 1986). Without fraud in the purchase, there can be no liability on the part of Peat, Marwick for preparation of the documents because it could not assist fraud which occurred before its involvement.

We review summary judgments *de novo*, viewing the affidavits in the light most favorable to the nonmoving party. *Jett v.*

Sunderman, 840 F.2d 1487, 1491 (9th Cir. 1988). We review the district court's rulings on discovery for an abuse of discretion. *Id.*

To prevail on a cause of action for violation of section 10(b) of the Securities Exchange Act of 1934[3] and Rule 10b-5 of the Exchange Commission,[4] the investors must establish fraud "in connection with the purchase or sale of any security." This requirement actually contains two separate elements: "in connection with" and a "purchase or sale." The former requires a causal relationship between the fraud and the resulting injury. *See Basic Inc. v. Levinson*, 108 S.Ct. 978, 989 (1988); *In re Financial Corp. of America Shareholder Litigation*, 796 F.2d 1126, 1130 (9th Cir. 1986) ("This 'transactional nexus requirement is a species of causation [in fact]' ") (quoting *Hudson v. Capitol Mgmt. Intern., Inc.*, 565 F. Supp. 615, 622 (N.D. Cal. 1983)). *Cf. Ohashi v. Verit Indus.*, 536 F.2d 849, 853 (9th Cir.),

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3 Section 10(b) of the Securities Exchange Act of 1934, 15 U.S.C. § 78j(b) provides:

> It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce or of the mails, or of any facility of any national securities exchange—
>
> (b) To use or employ, in connection with the purchase or sale of any security registered on a national securities exchange or any security not so registered, any manipulative or deceptive device or contrivance in contravention of such rules and regulations as the Commission may prescribe as necessary or appropriate in the public interest or for the protection of investors.

4 Rule 10b-5 of the Securities Exchange Commission, 17 C.F.R. § 240.10b-5, provides:

> It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce, or of the mails, or of any facility of any national securities exchange,
>
> (a) To employ any device, scheme, or artifice to defraud,
>
> (b) To make any untrue statement of a material fact or to omit to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading, or
>
> (c) To engage in any act, practice, or course of business which operates or would operate as a fraud or deceit upon any person,
>
> in connection with the purchase or sale of any security.

cert. denied, 429 U.S. 1004 (1976) (the fraud alleged "was not in connection with the inducement nor concurrently with the exchange"). The latter, a "purchase or sale," requires an "actual purchase or sale of securities, or a contract to purchase or sell . . . ." *Blue Chip Stamps v. Manor Drug Stores*, 421 U.S. 723, 735 (1975). It is the purchase and sale element which is at issue here, and we view the *Blue Chip Stamps* contract requirement as controlling.

[2] Section 3(a) of the 1934 Act defines "purchase" and "sale." Unless the context otherwise indicates, "purchase" includes "any contract to buy, purchase, or otherwise acquire," and "sale" includes "any contract to sell or otherwise dispose of." 15 U.S.C. § 78c(13) and (14). However, these definitions are of limited utility in ascertaining the scope of section 10(b) and Rule 10b-5. Precisely when a transaction is finalized, thereby creating an obligation to buy or sell securities, is a "question of intent for the finder of fact." *Lewelling v. First California Co.*, 564 F.2d 1277, 1280 (9th Cir. 1977). Thus, it is necessary to evaluate the factual situations in other cases to determine whether the purchase or sale requirement was met in this case.

The investors contend the sale requirement is met under the following three cases: *Goodman v. Epstein*, 582 F.2d 388 (7th Cir. 1978), *cert. denied*, 440 U.S. 939 (1979); *Stephenson v. Calpine Conifers II, Ltd.*, 652 F.2d 808 (9th Cir. 1981), *overruled on other grounds, In re Washington Pub. Power Supply Sys. Sec. Litig.*, 823 F.2d 1349 (9th Cir. 1987) (en banc), and *United States v. Kormel, Inc.*, 230 F. Supp. 275 (D. Nev. 1964). From these cases the investors argue that each payment on a promissory note constituted a separate purchase. We address these cases in succession to demonstrate why each is distinguishable under the contract theory established in *Blue Chip Stamps*.

In *Goodman v. Epstein*, 582 F.2d 388 (7th Cir. 1978), holders of interests in limited partnerships sued the general partners under section 10(b). The district court instructed the jury that each capital contribution by the limited partners did not constitute a separate "purchase." The Seventh Circuit Court of Appeals reversed, finding that each response to a call for more capital was a separate purchase and therefore "any material

representations or omissions at that time were 'in connection with the purchase or sale' of a security, as required by § 10(b) and Rule 10b-5." *Id.* at 414.

Goodman is distinguishable. The agreements to purchase the securities did not contain specific dates upon which specific amounts were due. The relationship was ongoing. *Id.* at 412. The partnership agreement allowed the general partners to make a "capital call" at any time for amounts "up to $3,000,000." *Id.* at 394 n.14. The investment decisions were made over the course of the enterprise and were based upon its success. *Id.* at 412. That is, the investment decisions were made *in futuro*, not when the purchase agreement was executed. *Id.* at 413.

[3] In the case at bar, the terms and commitments were unconditional in the subscription,[5] promissory note[6] and part-

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5 The subscription agreement [i.e., one example] provided:

* * *

I realize that the subscription price of each unit is $150,000, which is with full recourse to all of my personal assets.

* * *

For each full Unit indicated below, the undersigned delivers $12,500 in cash and two negotiable promissory notes in the face amount of $12,500 due on April 15, 1982, and April 15, 1983 respectively.

Number of Units subscribed: [ONE]
(not less than one)

Amounts delivered:	
Check:	[$ 12,500.00]
Note due April 15, 1982	[$ 12,500.00]
Note due April 15, 1983	[$ 12,500.00]
Obligations due December 31, 1994, 1995 and 1996 (Total: $112,500 per Unit)	[$112,500.00]
Total subscription price	[$150,000.00]

6 The promissory note provided in part:

Each maker and endorser hereby forever severally waives presentment, demand for payment, protest and notice of maturity, notice of protest or notice of dishonor of this note and all requirements necessary to hold each of them liable as makers and endorsers.

nership agreements.[7] Unlike the *Goodman* investors who had the legal alternative not to contribute to a capital call, these investors were required to pay the promissory notes. Their commitments were unconditional. *See Lewelling*, 564 F.2d at 1280.

The investors also argue this case is controlled by *Stephenson v. Calpine Conifers II, Ltd.*, 652 F.2d 808 (9th Cir. 1981), *overruled on other grounds, In re Washington Pub. Power Sup. Sys. Sec. Litig.*, 823 F.2d 1349 (9th Cir. 1987) (en banc) (no implied private right of action under section 17(a) of the Securities Act of 1933). In *Stephenson*, investors in limited partnerships brought a section 10(b) action for failure to disclose information known by insiders. In reversing summary judgment for the insiders, we held as a matter of law that section 10(b) liability cannot attach where the actionable conduct took place after the last date of investment. *Id.* at 813 (citing *Lewelling*). The actionable conduct must occur before the investors become "purchasers of securities as required by *Blue Chip*

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7 The partnership agreements provided in pertinent part, Article 3, § 3.2(a) and (b):

3.2 Capital Contributions of Limited Partners.

(a) Limited Partners will be admitted to the Partnership solely by subscription and upon the sole approval of the General Partners. By executing the Subscription Agreement, each Limited Partner agrees to contribute to the Capital of the Partnership the amount indicated on his Subscription Agreement.

(b) A Limited Partner subscribing to the Partnership will contribute to Partnership Capital the principal sum of $150,000 for each Partnership Unit subscribed. The capital contribution obligations of the Limited Partners shall be paid at the following times and in the following manner:

$12,500	in cash on subscription
$12,500	on or before April 15, 1982;
$12,500	on or before April 15, 1983;
$20,000	on or before December 31, 1994;
$20,000	on or before December 31, 1995;
$72,500	on or before December 31, 1996;

All of these capital contribution obligations will be full recourse obligations of the Limited Partners. The installments due in 1982 and 1983 bear simple recourse interest at the rate of 11½ percent per annum from the termination date. The installments due in 1994, 1995, and 1996 bear simple nonrecourse interest at the rate of 7 percent per year from the termination date.

Stamps v. Manor Drug Stores, 421 U.S. 723 (1975)." *Id.* (citations omitted).

Stephenson does not control here because it did not involve a completed, enforceable transaction. The *Stephenson* partnership articles provided that a default on capital contributions would incur limited liability. *Id.* at 812-13. This made the investments conditional. Thus, every later capital contribution was a new investment decision and therefore a "separate purchase."

In the case at bar, the partnership agreements required unconditionally that the full subscription price of $150,000 be paid. These investors did not have a "call" option available for subsequent capital contributions. There was no limited liability upon default. When the investors irrevocably committed themselves by signing the purchase agreements and paying the initial obligation, a purchase and sale of securities took place. The commitment to future payments was unconditional. It is this contractual relationship which is the determinative factor under *Blue Chip Stamps.*

Finally, unlike *United States v. Kormel, Inc.*, 230 F. Supp. 275, 278 (D.Nev. 1964), where the subscription contract was not complete until the *entire* purchase price was paid, here there was an express promise upon the initial subscription to pay the full sum. It was not an installment contract with the sale complete when the last payment was made. The existence of a completed contract made the investors purchasers on the date of initial subscription. Despite the investors' argument to the contrary, this is the established law of the circuit. *See Mosher v. Kane*, 784 F.2d 1385, 1389 (9th Cir. 1986), *overruled on other grounds, In re Washington Pub. Power Sup. Sys. Sec. Litig.*, 823 F.2d 1349 (9th Cir. 1987) (en banc) (the contractual relationship between the parties elevated them to the status of statutory purchasers); *Walling v. Beverly Enter.*, 476 F.2d 393, 396 n.5 (9th Cir. 1973) (sufficient contractual relationship); *Mount Clemens Indus., Inc. v. Bell*, 464 F.2d 339, 346 (9th Cir. 1972) (the lack of a contractual relationship is fatal to being afforded standing as a purchaser).

[4] The fraud alleged on the part of Peat, Marwick occurred after the investors made their subscription agreements with the

partnerships. Because the subsequent payments do not constitute separate purchases of securities, the investors' injury is not connected with the "purchase or sale" of a security under section 10(b). Since the purchase and sale occurred before the alleged fraud occurred, Peat, Marwick is absolved of section 10(b) primary liability. As a result, the district court properly granted summary judgment to Peat, Marwick on this claim.

2. Aiding and Abetting a section 10(b) Violation

The investors also charged Peat, Marwick with aiding and abetting a section 10(b) and Rule 10b-5 violation because it participated in partnership offering memoranda. The district court dismissed this allegation with prejudice for failure to state a claim. We review dismissal for failure to state a claim *de novo, In re Financial Corp. of America Shareholder Litig.*, 796 F.2d 1126, 1127 (9th Cir. 1986). Our review is limited, however, to the contents of the complaint to see if it "appear[s] to a certainty" that the plaintiff would not be entitled to relief under any set of facts that could be proved. *Id.* at 1128.

In substance, the investors' fourth amended complaint recited the following facts, the truth of which is presently assumed: (1) the offering documents indicated that Peat, Marwick agreed to perform accounting services for the partnerships; (2) before Peat, Marwick agreed to perform future services, it reviewed the offering memoranda and investigated partnership management, learning of fraudulent material; (3) through this process, Peat, Marwick participated in drafting the memoranda or had effective control over the contents by consenting to the use of its name; (4) Peat, Marwick audited and opined on the financial statements of, and prepared the tax returns for the partnerships for the years ending December 31, 1981, December 31, 1982, December 31, 1983, and December 31, 1984; (5) these opinions were disseminated to the investors; and (6) by assisting in the preparation of the memoranda and its investigation of the management of the partnerships, Peat, Marwick knew in what respects the memoranda were false and misleading, and furthered the fraud by consenting to inclusion of its name.

[5] Aiding and abetting is itself a violation of section 10(b) and Rule 10b-5. The elements for a cause of action for aiding and abetting a section 10(b) violation are: (1) the existence of an independent wrong, (2) actual knowledge by the alleged aider and abettor of the wrong and of his or her role in furthering it, and (3) substantial assistance in the wrong. *Jett*, 840 F.2d at 1495; *Harmsen v. Smith*, 693 F.2d 932, 943 (9th Cir. 1982), *cert. denied*, 464 U.S. 822 (1983). Defendants may be liable for aiding and abetting based on their silence if they have a duty to disclose knowledge that would be material to investors. *Strong v. France*, 474 F.2d 747, 752 (9th Cir. 1973). The secondary violator's duty to disclose may arise from a "knowing assistance of or participation in a fraudulent scheme." *Harmsen*, 693 F.2d at 944 (quoting *Strong*, 474 F.2d at 752).

[6] The investors have pled an independent wrong—a section 10(b) violation by other entities. In addition, investors have alleged that Peat, Marwick knew of the alleged violation but allowed the use of its name in offering memoranda despite that knowledge. These facts may be sufficient to create a duty to disclose in Peat, Marwick. Investors can reasonably be expected to assume that an accounting firm would not consent to the use of its name on reports and offering memoranda it knew were fraudulent. Thus, it may be reasonable to expect an accountant to disclose fraud in this type of situation, where the accountant's information is superior and the cost to the accountant of disclosure is minimal. *See Rudolph v. Arthur Andersen & Co.*, 800 F.2d 1040, 1045 (11th Cir. 1986), *cert. denied*, 107 S.Ct. 1604 (1987).

Peat, Marwick relies on *Barker v. Henderson, Franklin, Starnes & Holt*, 797 F.2d 490 (7th Cir. 1986). That case, however, involved a summary judgment, not a motion to dismiss. No evidence was produced by the plaintiffs of any intent to deceive by the defendants, that the defendants had even seen any of the selling documents during the relevant period, that they intentionally or recklessly gave bad advice to the sellers, or that their names were used in the prospectus. *Id.* at 493-96. In this case, however, plaintiffs have sufficiently alleged knowledge on the part of Peat, Marwick to create a possible duty to disclose information concerning the alleged fraud.

Similarly, whether Peat, Marwick knew of and substantially assisted in the wrong depends on the circumstances. *See S.E.C. v. Rogers*, 790 F.2d 1450, 1460 (9th Cir. 1986). The investors' complaint states a cause of action because it alleged that the investors relied on Peat, Marwick's reputation when deciding to invest and that they would not have invested had Peat, Marwick disclosed the alleged fraud. *See Rudolph*, 800 F.2d at 1044-45.

The complaint is sufficiently pled. Whether the cause of action for aiding and abetting is proven or can survive a motion for summary judgment is a factual issue to be determined by the district court. In light of the contents of the complaint, we hold the district court erred in prematurely dismissing the aiding and abetting claim for failure to state a claim.

3. Houston Harbaugh's section 10(b) Violation for Title Opinions

[7] The investors' complaint also alleged that the law firm of Houston Harbaugh prepared title opinions for property purchased by some of the partnerships which appeared in offering memoranda. Houston Harbaugh allegedly knowingly failed to indicate in the opinions that an interested party, Werner Heim, sold the property to the partnerships at inflated prices. This failure was alleged to be a violation of section 10(b) and Rule 10b-5. It was also alleged that Houston Harbaugh failed to reveal its conflict of interest with the partnerships because Heim was its client with interests adverse to the partnerships. The district court dismissed these allegations for failure to state a claim. The investors do not contend the title opinions were inaccurate. Rather, the investors allege the title opinions were misleading since they failed to disclose the interest of Heim in the property and the law firm's other representation of Heim.

The title opinions should have contained the omitted information only if the law firm had a duty to disclose it. The court determines whether a duty to disclose exists by examining five non-exclusive factors first enumerated by this court in *White v. Abrams*, 495 F.2d 724, 735-36 (9th Cir. 1974). The court examines:

1. the relationship of the defendant to the plaintiff;
2. the defendant's access to information as compared to the plaintiff's access;
3. the benefit that the defendant derives from the relationship with the plaintiff;
4. the defendant's awareness of plaintiff's reliance; and
5. the defendant's activity in initiating the securities transaction in question.

Pegasus Fund, Inc. v. Laraneta, 617 F.2d 1335, 1340 (9th Cir. 1980) (citing *White*, 495 F.2d at 735-36.

Unlike the allegations with respect to Peat, Marwick, no duty with respect to Houston Harbaugh could possibly be established by the facts alleged in the complaint. First, Houston Harbaugh was retained solely to determine marketability of title by reviewing the record of title; marketability alone was relevant to the duty owed the partnerships. The omitted information would not have provided the investors with information about the state of title affecting the partnerships' ability to purchase the property, albeit at an inflated price. Second, both parties had equal access to the records examined.[8] Finally, the defendants were in no way responsible for initiating these securities transactions.

Houston Harbaugh's duty under section 10(b) does not extend as far as the investors claim. Even if the facts alleged are true, Houston Harbaugh's duty cannot extend to disclosing the information the investors wanted when it was hired only to determine marketability of title. Otherwise, a party could be liable for unlimited information even though it would be well beyond the matter for which it was retained.

4. The Motions for Sanctions

[8] After Peat, Marwick moved for Rule 11 sanctions, the investors filed a cross-motion for sanctions, arguing that Peat, Marwick's Rule 11 motion violated Rule 11. The Rule 11 drafters' nightmare has become a reality. *See* 101 F.R.D. 161, 200

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8 The title opinions were based on examination of records in the Records of Deeds office.

(1984) (committee reporter described "Kafkaesque dream" of motions to sanction attorneys for making frivolous motions for sanctions).

Our standard of review on whether the conduct at issue violated Rule 11 is *de novo. Golden Eagle Dist. Corp. v. Burroughs Corp.*, 801 F.2d 1531, 1538 (9th Cir. 1986). We review factual determinations concerning the conduct under a clearly erroneous standard, while the appropriateness of the sanction imposed is reviewed for abuse of discretion. *Id.* The standard for appraising the actions of an attorney does not require proof of bad faith, but instead objectively looks to whether the signing attorney acted reasonably under the circumstances. *Hudson v. Moore Business Forms, Inc.*, 836 F.2d 1156, 1159 (9th Cir. 1987).

Rule 11's purpose was not to chill zealous advocacy. *See In re Yagman*, 796 F.2d 1165, 1182 (9th Cir. 1986), *amended*, 803 F.2d 1085, *cert. denied*, 108 S.Ct. 450 (1987). The Rule addresses filings which are not grounded in law or fact or filings used to harass. *Hudson*, 836 F.2d at 1159. It should not itself become a retaliatory device. The district court correctly denied both Rule 11 motions.

CONCLUSION

Summary judgment to Peat, Marwick on the separate purchase theory was proper; dismissal of the aiding and abetting claim against Peat, Marwick was improper, dismissal of the claim against Houston Harbaugh was proper since it owed no further duty to disclose; and denial of both motions for sanctions was proper.

Costs are awarded to Houston Harbaugh against Rogers and otherwise each party is to bear its own costs.

AFFIRMED IN PART, REVERSED IN PART, and REMANDED.

NOT FOR PUBLICATION

UNITED STATES COURT OF APPEALS

FOR THE NINTH CIRCUIT

Nos. 87-2106, 87-2128, 87-2278

D.C. No. CV-84-8069-TEH
(Northern District of California)

Filed: July 17, 1989

PHILLIP D. ROBERTS; LYNN ROBERTS; DENNY DELK; KAREN DELK; WILLIAM J. FRESCHI, on behalf of themselves and all others similarly situated,

Plaintiffs/Appellants/ Cross-Appellees,

—v.—

PEAT, MARWICK, MITCHELL & CO.,

Defendant/Appellee/ Cross-Appellant,

—and—

HOUSTON HARBAUGH, P.C.,

Defendant/Appellee.

Before:

SCHROEDER* and BOOCHEVER, *Circuit Judges*, and
STEPHENS,** *District Judge.*

ORDER

The panel as constituted above has voted to deny the petition for rehearing and to reject the suggestion for rehearing en banc.

The full court has been advised of the suggestion for rehearing en banc and no judge of the court has requested a vote on the suggestion for rehearing en banc. Fed. R. App. P. 35.

The petition for rehearing is denied and the suggestion for rehearing en banc is rejected.

* Judge Schroeder was drawn to replace Judge Anderson who died on April 16, 1988.

** Honorable Albert Lee Stephens, Jr., Senior United States District Judge for the Central District of California, sitting by designation.

UNITED STATES COURT OF APPEALS
FOR THE NINTH CIRCUIT

No. 87-2106, 87-2128, 87-2278

DC# CV-84-8069-TEH
Northern California
(San Francisco)

Filed July 25 1989

PHILIP D. ROBERTS, et al.,

Plaintiffs/Appellants/
Cross-Appellees,

vs.

PEAT, MARWICK, MITCHELL & CO.,

Defendant/Appellee/
Cross-Appellant,

and

AMERICAN ENERGY RESOURCES, INC.,

Defendant/Appellee.

ORDER

Before: SCHROEDER, *Circuit Judge*

Peat, Marwick's motion for Stay of Mandate is granted. The issuance of the mandate is stayed for thirty days to permit the filing of a petition for writ of certiorari in the Supreme Court of the United States.

UNITED STATES COURT OF APPEALS

FOR THE NINTH CIRCUIT

Nos. 87-2106, 87-2128, 87-2278

D.C. No. CV-84-8069-TEH

Filed: August 14, 1989

PHILIP D. ROBERTS, et al.,

Plaintiffs/Appellants,

—vs.—

PEAT, MARWICK, MITCHELL & CO.,

Defendant/Appellee/ Cross-Appellant,

—and—

AMERICAN ENERGY RESOURCES, INC.,

Defendant/Appellee.

Before:

SCHROEDER, *Circuit Judge*

ORDER

Peat, Marwick's motion for an additional thirty day Stay of Mandate is granted pending the filing of a petition for writ of certiorari in the Supreme Court of the United States.

UNITED STATES DISTRICT COURT
N.D. CALIFORNIA

No. C 84-8069 TEH.

March 23, 1987.

PHILIP D. ROBERTS, et al.,

Plaintiffs,

v.

WERNER HEIM, et al.,

Defendants.

David B. Gold, George Donaldson, Solomon B. Cera, San Francisco, Cal., Philip D. Roberts, Winokur, Maier & Zang, Woodford G. Rowland, San Rafael, Cal., for plaintiffs.

Ernest Y. Sevier, Loraine P. Eber, Severson, Werson, Berke & Melchior, San Francisco, Cal., for defendants Somers & Altenbach and Robert E. Altenbach.

Boake Christensen, Richard North Patterson, McCutchen, Doyle, Brown & Enersen, San Francisco, Cal., for defendant Peat, Marwick, Mitchell & Co.

James Robertson, Patricia D. Douglass, Wilmer, Cutler & Pickering, Washington, D.C., for defendant Lewin and Associates, Inc.

Robert J. Glynn, Gary A. Cerio, Glynn & Harvey, San Francisco, Cal., for defendant Baskin & Steingut fka Baskin & Sears.

Karen L. Hawkins, Christina Johnson, Taggart & Hawkins, San Francisco, Cal., for defendant Neil Rogen.

James A. Cunningham, Boulder, Colo., in pro per.

Kurt C. Peterson, Mary C. Oppedahl, Crosby, Heafey, Roach & May, Oakland, Cal., for defendant T. Kenneth Pyles.

David B. Epstein, Charles Marshall, Margolis, McTernan, Scope & Epstein, Los Angeles, Cal., for defendants Todd M. Doscher, The Doscher Group, Inc., and CLD Group, Inc.

Dennis M. Bourquin, Los Altos, Cal., for defendant William R. Conklin.

Kenneth D. Robin, San Francisco, Cal., for specially appearing non-defendants/TRO Respondents Energy Reserve Resources, Ltd., T. Michael Carrington, Joseph Babich and Larry Melnick.

George B. Richardson, Holtzman, Wise & Shepard, Palo Alto, Cal., and R. Nicholas Gimbel, Holtzman, Wise & Shepard, New York City, for defendants Lewin Energy Corp., Vello A. Kuuskraa, Technology Catalysts, Inc. and R.L. DiCicco.

Ernest M. Anderson, Eckhoff, Hoppe, Slick, Mitchell & Anderson, San Francisco, Cal., and Dan Biles, Gates & Clyde Chartered, Overland Park, Kan., for defendant C. Norris Taylor, Jr.

Richard A. Ardoin, Bronson, Bronson & McKinnon, San Francisco, Cal., Michael H. Greenberg, Gary S. Mayerson, Graubard, Moskovitz, Dannett, Horowitz & Mollen, New York City, for defendant Richard B. Basile.

Robert L. Leberman, Cheryl G. Weisbard, Sideman & Bancroft, San Francisco, Cal., for defendants American Energy Resources, Inc., AER Investments, Inc., The Forsee Group, Ltd., Drake Oil Technology Partners, Vulcan Oil Technology Partners, Vanguard Oil Technology Partners, Derringer Oil Technology Partners 1981, Crown Oil Technology Partners, Dillon Oil Technology Partners, Derringer Oil Technology Partners 1982, Castaic Oil Technology Partners, Carlton Oil Technology Partners, Ltd., and Louis F. Coppage (partnership defendants).

A. James Roberson II, Michael Q. Eagan, Peter J. Busch, Howard, Rice, Nemovski, Canady, Robertson & Falk, San Francisco, Cal., for defendant Friedman and Shaftan, P.C.

Tristam B. Brown, James J. Corbelli, Lillick, McHose & Charles, San Francisco, Cal., for defendant Houston Harbaugh, P.C.

George J. Ziser, Andrew C. Wolin, Moore, Clifford, Wolfe, Larson & Trutner, Oakland, Cal., for defendants Schumacher & Hickey and Frederick R. Schumacher, Ltd. a P.C.

Stephen C. Tausz, Richard A. Ardoin, Stephen D. Colwell, Bronson, Bronson & McKinnon, San Francisco, Cal., for defendant Glenda Exploration and Development Co.

Darrell D. McCullough, Denver, Colo., in pro per.

Roger B. Pool, Mark D. Petersen, Farella, Braun & Martel, San Francisco, Cal., for defendant Fox & Co.

Richard Haas, Lasky, Haas, Cohler & Munter, San Francisco, Cal., for Robert E. Altenbach.

Gersten, Savage, Kaplowitz & Zukerman, Edward R. Curtin, New York City, for Richard Basile, and Manhattan Partnership.

Robert D. Radcliffe, Salt Lake City, Utah, for Werner Heim, et al.

David M. Greenberg, Professional Corp., San Francisco, Cal., for Texoil Intern., Inc.

E. Lawrence Brock, Salt Lake City, Utah, for Am. Energy Resources, Aer, Foresee Grp., Louis F. Coppage and Denver Partnerships.

ORDER CONCERNING MOTIONS TO DISMISS, FOR SUMMARY JUDGMENT, FOR CLASS CERTIFICATION AND FOR SANCTIONS

THELTON E. HENDERSON, District Judge.

Plaintiffs in this action are six individuals who invested in four limited partnerships ostensibly organized to produce oil and gas through the use of new "enhanced oil recovery technology" ("EOR"). These named plaintiffs are attempting to proceed as class representatives for over 1000 persons who invested in these four partnerships and in 36 other similar partnerships offered between 1979 and 1983. In their Fourth Amended Complaint, plaintiffs advance claims under Sections 12, 15 and 17(a) of the Securities Act of 1933, Sections 10(b) and 20(a) of the Securities Exchange Act of 1934, Rule 10b-5, Section 1965 of

the Racketeer Influenced and Corrupt Organizations Act ("RICO"), and applicable California law. Plaintiffs have named over 100 defendants, including the partnerships, the general partners, the individuals and corporate entities alleged to be the moving forces behind the partnerships, and an array of accountants, attorneys and consultants who provided services to the partnerships. Plaintiffs allege these 40 partnerships represent a worldwide conspiracy to defraud investors out of hundreds of millions of dollars.

The crux of the scheme as alleged by plaintiffs is as follows. Plaintiffs claim that certain individuals, led by defendant Heim, originated the idea of forming these partnerships to sell the investing public on the concept of EOR technology. These individuals recruited the general partners and then arranged for the partnerships to purchase for exorbitant fees from their corporate alter egos the exclusive license to use this "new" technology. Plaintiffs allege this technology was unproven and basically without value, and that the licensors did not have the right to grant an exclusive license. Plaintiffs further allege the partnerships purchased mineral rights from other corporate alter egos of Heim and the others at prices between 700 and 10,000 times their real value. Plaintiffs also contend that the professional defendants were aware, or should have been aware, of the nature and scope of this scheme, and thus joined—at least tacitly—in the scheme to defraud.

On May 21, 1986, the court dismissed plaintiffs' Third Amended Complaint with leave to amend to cure pleading deficiencies identified by the court. The court cautioned plaintiffs that those deficiencies remaining in the next amended complaint would be dismissed with prejudice. This matter now comes before the court on motions filed by defendants in response to the Fourth Amended Complaint and on plaintiffs' motion for class certification. The court heard oral argument on the former motions on August 11, 1986; argument on the class certification issue took place on October 20, 1986. On October 20, 1986 the court also took under submission defendant Peat Marwick's motion to strike class allegations against it and for sanctions, and plaintiffs' cross-motion for sanctions.

For the reasons stated below, these motions are granted in part and denied in part.

I. MOTION FOR SUMMARY JUDGMENT

A. *Promissory Note Payments As Securities Purchases*

Defendants have moved for partial summary judgment on the issue of whether the promissory note payments made by plaintiffs constituted separate purchases of securities. Defendants first raised this issue in response to the Third Amended Complaint. At that time, the court ruled that the record was not sufficiently developed to permit a finding on the question of plaintiffs' intent in making the promissory note payments. For the reasons stated below, the court finds the record now permits an informed ruling on this issue and hereby grants this motion.

While the precise details of each plaintiff's investment may vary, the basic facts are the same.[1] The investments in the Denver partnerships provide a typical example. When investing in the partnerships, each plaintiff made a commitment to provide $150,000 to the partnership. This commitment consisted of a $12,500 payment at the time of subscription, and the execution of promissory notes for the balance. Two of these notes were short-term with each partner agreeing to pay $12,500 in each of the first two years following the formation of the partnerships. The remaining promissory notes were of longer duration with each partner promising to provide $112,500 in three installments fourteen to sixteen years from subscription. In the first years of the partnerships, investors typically claimed tax deductions equal to four or five times each year's cash payment.

In bringing this lawsuit, plaintiffs have advanced claims against defendants who were not involved with the alleged scheme to defraud until after plaintiffs made their initial partnership contributions. These defendants generally became involved with the partnerships during the initial years of their

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1 The amount of the subscription cost of a unit in each partnership varied, as did the timing of the promissory note payments. However, plaintiffs have not identified any differences in the material facts relevant to this motion.

existence. Plaintiffs contend that each payment on a promissory note constituted a separate investment decision and thus any defendant who participated in the transactions before any of the subsequent promissory note payments were made is liable for fraud in the sale of a security.

Defendants assert these promissory note payments did not constitute separate purchases. They contend any defendant not associated with the partnerships at the time of plaintiffs' initial investments therefore cannot be liable for fraud in the sale of a security.[2] The court agrees that the promissory note payments did not constitute separate security purchases.

A purchase of securities occurs when the buyer and seller are "committed" to the transaction; commitment occurs at "the point at which the parties obligated themselves to perform what they agreed to perform even if the formal performance of their agreement is to be after a lapse of time." *Radiation Dynamics, Inc. v. Goldmuntz*, 464 F.2d 876, 891 (2d Cir.1972). Plaintiffs made their commitment to defendants at the time of their initial cash contributions to the partnerships. At that time they also signed promissory notes, which are traditionally viewed as unconditional obligations to pay a sum certain, thereby fixing the maker's repayment obligation at the time they are executed. See, 3A A.L. Corbin, *Corbin on Contracts* ¶¶ 624-27 (1960); 10 W.H.E. Jaeger, *Williston on Contracts* § 1159 (3d ed. 1967).

The facts surrounding the execution of these notes demonstrate plaintiffs' obligations were fixed and they were liable for the full extent of the promissory notes at the time the notes were signed. Plaintiffs admit they executed the promissory notes as part of the total purchase price for each partnership unit. Plaintiffs granted the partnerships significant rights to ensure full payment on this obligation. In the event of non-payment on any note, the partnerships were entitled to foreclose on plaintiffs' partnership interests and immediately accelerate plaintiffs' obligation on all outstanding promissory notes. To ensure collection of all amounts due, the partnerships had full recourse to all

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2 Plaintiffs have also alleged that certain defendants who aided the partnerships after the initial subscription period are liable under § 10(b) for conspiring to defraud plaintiffs. This theory of liability is discussed elsewhere in this Order.

of plaintiffs' personal assets. The subscription agreements signed by plaintiffs clearly described the extent of their personal obligation; for example, the Boulder Oil and Gas Associates 1980 ("Boulder '80") subscription agreement stated "I realize that the subscription price of each unit is $150,000 which is with full recourse to all of my assets." In their declarations, plaintiffs have conceded that no one ever told them that the partnerships might relieve them of these obligations and that they knew they were legally obligated to make these payments.

Plaintiffs contend these facts do not conclusively prove that they were committed to making the promissory note payments. Plaintiffs advance several theories to demonstrate that they may have been able to avoid making the promissory note payments. They argue this power of avoidance makes each payment a separate investment decision. Plaintiffs further contend that the issue of whether a note payment is a purchase of a security is a question of intent for the trier of fact (*citing Stephenson v. Calpine Conifers II, Ltd.*, 652 F.2d 808, 812-13 (9th Cir. 1981). Plaintiffs argue it would thus be inappropriate for the court to resolve this issue by summary judgment. Finally, they assert they have not had an opportunity to conduct full discovery and a ruling on this issue is therefore premature. The court will address each of these contentions.

The court recognizes that the Ninth Circuit has cautioned courts against ruling on questions of intent at the early stages of a case. *Stephenson*, 652 F.2d at 812-13. It was for this reason that the court declined to rule on this issue when first raised in a motion to dismiss the Third Amended Complaint. However, it is not always inappropriate to rule on questions of intent without the benefit of trial. Where, as here, the facts before the court clearly demonstrate the parties' intent, summary judgment may be appropriate. *See, e.g., Hudson v. Capital Management Int'l., Inc.*, No. C 81 1739 MHP (N.D.Cal. March 7, 1984) ("*Hudson III*") [Available on WESTLAW, DCT database].

The facts before the court are quite different from those before the court in *Stephenson*. First, *Stephenson* involved capital contribution calls, not payments on promissory notes. More important, in *Stephenson*, the trial court made an incorrect

assumption about plaintiffs in that action which does not apply here. The *Stephenson* court assumed that plaintiffs were irrevocably committed to make the capital contributions and thus these contributions did not constitute separate investment decisions. In overturning the trial court's summary judgment ruling, the Ninth Circuit noted that plaintiffs had "limited liability" from any default and concluded that this limited liability raised the real possibility that plaintiffs would choose to default. *Id.* In contrast here, the partnerships had full recourse to all of plaintiffs' personal assets in the event of non-payment. Under these circumstances, the court finds the possibility of non-payment was extremely remote and that plaintiffs were fully committed to making the payments. *See Hudson III, supra.*

Moreover, plaintiffs indicated their intent to make these payments by the tax deductions claimed for the first year of their partnership investments. Plaintiffs concluded that all of the sums promised to the partnership were "at risk" at the time of subscription and deducted a share of partnership losses far in excess of their initial cash contributions. The alleged validity of these deductions was premised on plaintiff's obligation to make *all* of their note payments, otherwise the plaintiffs would not be "at risk" for more than their cash contribution. As Judge Patel noted in *Hudson III*, for plaintiffs now to argue that their note payments were not fixed would be to adopt a position inconsistent from that taken with the I.R.S. *Id.* at 14.[3]

Plaintiffs also assert the evidence suggests that the partnerships would not have enforced the non-payment provisions of

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3 Plaintiffs attempt to distinguish this case from *Hudson* by pointing out that the plaintiffs in *Hudson* deducted the full amount of *all* of the promissory notes in the first year and would have owed the government money had they not made the subsequent note payments. Here, plaintiffs deducted in the year of contribution only a *portion* of the money "at risk" from notes. Plaintiffs assert they would not have been liable for additional tax payments had they not made the promissory note payments. The court finds this to be a distinction without a difference. Moreover, even assuming plaintiffs' deductions were based on the long-term notes, this does not remove the inconsistency inherent in taking a tax deduction based on the definiteness of a long-term note and then arguing that identical short-term notes were discretionary.

the notes other than by confiscating a plaintiff's capital account or trying to find a new investor to assume the obligation. Plaintiffs suggest these limited responses provided them with a real opportunity to avoid making the note payments. However, this speculation presupposes plaintiffs' breach of their agreement, "the possibility of which does not give rise to an 'investment decision' constituting a purchase under the securities laws." *Id.* at 11-12. Moreover, finding someone to assume the obligation of a breaching investor "at most would [result] in an assignment of plaintiffs' payment obligations, not a termination of such obligations." *Hill v. Equitable Bank, Nat. Assn.*, 599 F. Supp. 1062, 1073 n.11 (D.Del.1984).

Plaintiffs also suggest they might have dissolved the partnership before the promissory notes came due. Judge Patel rejected a similar argument as "patently spurious" in *Hudson*. This court reaches a similar conclusion here, as dissolution required the consent of 70% of the partners. The possibility of this unified action is too remote to provide the basis for converting a mandatory note payment into a discretionary decision.

Plaintiffs' final argument is that they have not had sufficient opportunity to conduct discovery on this issue and a summary judgment ruling is therefore premature. Unlike some of the other complex securities cases cited by plaintiffs in support of this argument, the key information in this matter is not in the exclusive control of defendants. All the evidence concerning plaintiffs' intent is within the possession of plaintiffs. *Cf. Alabama Farm Bureau Mutual Casualty Co., Inc. v. American Fidelity Life Insurance Co.*, 606 F.2d 602 (5th Cir.1979). Plaintiffs have not introduced any evidence to suggest that at the time they executed the notes they thought they had a choice about whether or not to make the payments. In fact, all the evidence suggests they knew they were obligated to make the payments when the notes came due. Plaintiffs' arguments based on defendants' hypothetical intent have also been rejected; thus, additional discovery to prove the facts underlying these arguments would be unavailing.

Having considered the evidence and memoranda submitted by all parties, the court finds there are no genuine issues of

material fact concerning plaintiffs' obligation to make their promissory note payments. The court finds plaintiffs committed themselves to making these payments at the time they signed the notes. Therefore, plaintiffs' subsequent payments did not constitute separate investment decisions under the securities laws.

II. MOTIONS TO DISMISS

A. *RICO Claim*

In the May 21 Order, the court dismissed plaintiffs' RICO claim with leave to amend to correct the pleading deficiencies. Having examined the Fourth Amended Complaint, and the memoranda submitted by the parties, the court finds plaintiffs have not adequately alleged a claim under RICO. For this reason, the court dismisses the RICO claim with prejudice.

In its prior order, the court directed plaintiffs to identify separately in any amended complaint the alleged RICO "enterprise" and the defendants who conducted their illegal activities through that enterprise. *See* Order at 17-18 (citing *Rae v. Union Bank*, 725 F.2d 478, 481 (9th Cir. 1984) for the proposition that a defendant cannot simultaneously be the RICO defendant and the enterprise). In their Fourth Amended Complaint, plaintiffs have advanced two theories in an attempt to correct their pleadings. They assert first that a sub-group of defendants, the Petrotec Entities, constituted the enterprise. In the alternative, they argue that the enterprise was an association-in-fact made up of all the defendants.

An association may serve as the enterprise in a claim under RICO. However, the courts have held that, in this context, an association means a group of "individuals." *United States v. Turkette*, 452 U.S. 576, 101 S. Ct. 2524, 69 L.Ed.2d 246 (1981). Plaintiffs argue "individuals" may encompass a group of persons and business entities, but have cited no authority for this assertion. The court does not agree. When used in this context, the term "individuals" refers to individual living persons and not to an association or enterprise. *See e.g. United States v. Computer Sciences Corp.*, 511 F. Supp. 1125, 1131 (E.D. Va. 1981).

Plaintiffs have also failed to cite any authority for the proposition that a sub-group of defendants can constitute the enterprise under RICO. In paragraph 136 of the complaint, plaintiffs assert the Petrotec Entities constituted the enterprise. In that same paragraph, they also identify four Petrotec companies engaged in the technology licensing business which were in existence prior to the formation of the alleged conspiracy. These allegations reveal the continued lack of coherence of plaintiffs' assertion. Plaintiffs fail to indicate whether they are claiming that all 26 Petrotec Entitites constituted the enterprise, or if the enterprise was made up of just the four companies whose existence preceded the alleged conspiracy. Moreover, these Petrotec Entities are the same companies identified elsewhere in the complaint as controlling the scheme to defraud plaintiffs. ¶ 107,115. This assertion that the "enterprise" controlled the remaining defendants is the same type of inconsistent conflation of the enterprise and defendant concepts complained of in the May 21 order. As plaintiffs have failed to correct this inconsistency, their RICO claim is dismissed with prejudice.

B. *Section 17(a)*

In their Fourth Amended Complaint, plaintiffs raise for the first time a claim under Section 17(a) of the Securities Act of 1933. In accordance with most of the courts in this District, this court has not recognized the availability of a private right of action under § 17(a). Plaintiffs assert the language in a recent Ninth Circuit decision, *Mosher v. Kane*, 784 F.2d 1385, 1390 n.9 (1986), compels the recognition of a private right of action. Having reviewed this case, and the Northern District of California cases decided since *Mosher*, *see, e.g. Gordon v. Tyndall*, No. C 86 1397 (WHO) [Available on WESTLAW, DCT database], *Lindemuth Co. v. Shannon Financial Corp.*, 637 F.Supp. 991, the court is still persuaded no private right of action exists under Section 17(a). For this reason, plaintiffs' claim under this section is dismissed.

C. Claims Under Sections 12 of the 1933 Act

Plaintiffs have advanced claims against a variety of defendants under Section 12 of the 1933 Act. Section 12 imposes liability on any person who sells a security in violation of the Act's registration provisions (§ 12(1)) or who uses a misleading prospectus or oral statement in the sale of a security (§ 12(2)). Defendants assert these claims are infirm both for failing to properly allege seller status and for not being brought within the applicable statute of limitations.

1. Statute of Limitations

In light of this court's ruling that the promissory note payments did not constitute sales of securities, three of the four named plaintiffs have failed to advance timely claims under this section. Section 13 of the Act provides that no action can be brought under § 12(1) more than three years after the security was offered to the public or under § 12(2) more than three years after the sale of the security. 15 U.S.C. § 77m. Plaintiff Bell bought his partnership unit in Boulder Associates in 1980; plaintiffs Roberts made their purchase in Drake Oil Technology Partners ("Drake '81") on December 12, 1981; plaintiffs Delk made their purchase in Vanguard Oil Technology Partners ("Vanguard '81") on December 28, 1981. As these three plaintiffs did not file their first complaint in this action until December 31, 1984, their claims under § 12 are time barred.

Plaintiff Gauss, however, alleges he bought his unit in the Dillon Oil Technology partnership ("Dillon '82") on or about December 28, 1982. As his claim was added in the Third Amended Complaint filed in September 1985, it is not barred by the three year absolute limit of § 13. For the reasons stated in the court's Order of May 21, the court also finds Gauss' claim is not barred by the other time limitations set forth in Section 13.[4]

4 In their opposition papers on the class certification motion, defendants ask the court to reconsider its ruling on the tolling provisions of § 12(1). Having reviewed the authorities cited by the parties, the court declines to reverse its prior ruling.

For the reasons stated above, the claims under § 12 by plaintiffs Roberts, Bell and Delk are dismissed with prejudice.

2. Seller Status

As plaintiffs Roberts, Delk, and Bell did not state timely claims under § 12, only those defendants who were involved in the sale of the partnership unit to plaintiff Gauss are potentially liable under § 12. The court therefore dismisses the § 12 claims against defendants Krause, Energy Associates, Basile and Taylor as none of them were involved with any entity associated with the Dillon '82 partnership. The court also dismisses the § 12 claim against defendant Pyles. Gauss alleges he became involved with AER in 1983 following Gauss' purchase of this partnership unit.

Gauss has also failed to state a claim against defendant Conklin. Liability under § 12 falls only on those "whose participation in the buy-sell transaction is a substantial factor in causing the sale to take place." *Pharo v. Smith*, 621 F.2d 656, 667 (5th Cir.1980); *accord*, *Admiralty Fund v. Jones*, 677 F.2d 1289, 1294 (9th Cir.1982). In their opposition papers, plaintiffs suggest Conklin "substantially assisted" the sale of partnership units by either organizing them or being responsible for their success. Plaintiffs' Opposition at p. 31-32. However, a review of the allegations of the complaint belies this assertion. In paragraph 56(a), Conklin is identified as an officer of several Petrotec Entities. This status, by itself, does not suggest that he organized or was responsible for the success of the partnerships. Nor do the allegations that he assisted Heim in acquiring properties, managed the affairs of Tulesbond and other companies, and served as "escrow agent" for the collection of license fees support an inference that he was an organizer or principal actor in the affairs of the partnerships. These allegations detail a significant level of involvement in Heim's affairs, but they fail to suggest Conklin was a substantial factor in the direct sale of the partnership units.

Gauss also has not stated a claim against most of the Petrotec Entities. He alleges that all 26 Petrotec Entities are somehow "sellers" of the partnership units. In the May 21 Order, the

court dismissed the § 12 claims against these companies with leave to amend with greater detail concerning how all Petrotec Entities were responsible for selling the securities. Plaintiff has responded by repeating the prior claims practically verbatim and then arguing that all of the entities were "issuers" of the partnership units by virtue of the fact that they "were either responsible for organizing the partnerships or for determining their success or failure." Plaintiff's Opposition at p. 32. Though the Ninth Circuit case of *SEC v. Murphy*, 626 F.2d 633, 642 (1980), does suggest that organizing entities can be issuers, the cases cited by the Ninth Circuit in illustration involved situations where one or two entities were clearly responsible for the partnerships. *See Doran v. Petroleum Management Corp., Inc.*, 545 F.2d 893 (5th Cir.1977); *Bayoud v. Ballard*, 404 F.Supp. 417 (N.D.Tex.1975). Here plaintiffs allege that 26 companies and a multitude of individuals were all responsible for the partnerships' survival. In the absence of additional specificity as required by the terms of the May 21 Order, these allegations will not suffice to state a claim against the Petrotec Entities under § 12. The claim against American Energy Resources (AER), the corporate general partner for Dillon '82 can go forward; the § 12 claims against the remaining Petrotec Entities are dismissed.

Gauss has also asserted claims against various officers of AER. Gauss does not allege that he had any contact with defendants Cunningham, Bogdan, LaGuardia or McCullough. His claim must therefore be based on the theory that these officers, by virtue of their position within AER, were substantial factors in the issuance of the securities. After reviewing the allegations in all sections of the complaint detailing the activities of these defendants, the court finds plaintiff has not alleged sufficient facts to support a claim of substantial participation against them.

Plaintiff has also alleged defendant Rogen substantially participated in the sale of securities by virtue of his involvement with Elektra Energy Corp. The court finds Mr. Rogen's association with Elektra did not elevate him to the status of a seller of the partnership units.

Plaintiff Gauss has stated a claim for relief under § 12 against the remaining defendants.[5]

D. *Claims Under § 10(b) and Rule 10b-5*

Plaintiffs have alleged that all defendants have committed various violations under § 10(b) and Rule 10b-5. Some defendants are charged with being principal violators, some are accused of secondary violations, and all are alleged to have conspired to violate the statute.

In its May 21 Order, the court acknowledged that plaintiffs' pleadings concerning many of the alleged principal violators were sufficient. The court found, however, that plaintiffs had not adequately identified which defendants were alleged to be principal violators and which were charged with secondary liability. The court therefore dismissed the Third Amended Complaint but granted leave to amend to cure this deficiency. The court also held that plaintiffs' conspiracy allegations were not adequately detailed and dismissed with leave to add the requisite details if possible. The court further questioned whether plaintiffs had adequately alleged a "transactional nexus" between their injuries and the conduct of certain defendants, but refrained from ruling on this issue until the conspiracy claims had been alleged with more detail and the motion for class certification was filed.

In response to the Fourth Amended Complaint, defendants have once again raised objections to the sufficiency of some of plaintiffs' allegations. The court will first address the challenges to the charges of primary liability and then turn to the claims of conspiracy and aiding and abetting.

1. Primary Liability

Many defendants argue that plaintiffs have failed to state a claim against them for primary liability under Section 10(b). The court will analyze each defendant's argument separately.

Plaintiffs have stated a cognizable claim against defendant Rogen. Primary liability under § 10(b) and Rule 10b-5 may be

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5 No other defendants have challenged the sufficiency of plaintiffs' § 12 claims.

predicated on either affirmative misrepresentations, or upon omissions to state facts material to the transactions by those under a duty to disclose those facts to plaintiffs. *White v. Abrams*, 495 F.2d 724 (9th Cir.1974). Plaintiffs allege Rogen was president first of Elektra Energy Corporation and then of Hemisphere Licensing Corporation during the period 1980 until 1984. Plaintiffs claim that by virtue of this position, Rogen knew, or was reckless in not knowing, certain material facts omitted from the partnership prospectuses. (Complaint, ¶ 55(f)). Rogen argues that he was not under any duty to disclose this information to plaintiffs. In *White v. Abrams*, the Ninth Circuit adopted a flexible standard for appraising the duty an individual owes to divulge information to investors. *Id.* at 735. The court finds plaintiffs have alleged enough facts to suggest Rogen may have had a duty to disclose additional information to investors. The question of the extent of this duty is an issue of fact not appropriate for resolution in a motion to dismiss.

Houston Harbaugh prepared title reports which were included in some prospectuses. Plaintiffs allege Houston Harbaugh is liable as a principal under § 10(b) for failing to reveal in these reports that the prior owners of the properties were entities allegedly controlled by defendant Heim and for failing to state that the prices to be paid by the partnerships for the mineral rights were many hundred times the prices originally paid by Heim's companies.

Houston Harbaugh attacks these allegations on two grounds. First, it alleges that—even assuming the facts as pled to be true—plaintiffs have not alleged any omissions which constitute a violation under 10(b). Houston Harbaugh also claims plaintiffs have failed to allege facts which indicate it possessed the requisite scienter.

Rule 10b-5 makes it unlawful for any person "to make any untrue statement of fact or to omit to state a material fact necessary to make the statements made, in the light of the circumstances under which they were made, not misleading." 17 C.F.R. 240.10b-5. Certain partnership prospectuses included opinions by Houston Harbaugh stating that title to property the partnership was to acquire was vested in defendant Tulesbond,

Ltd. Plaintiffs do not contest the truth of this opinion; rather, they claim the omitted information made these statements misleading.

The court does not agree. For the purposes of this motion the court accepts plaintiffs' contention that the omitted information was relevant to their investment decision. Nevertheless, this fact does not, by itself, suggest that Houston Harbaugh is liable for not including it in its title opinions. Plaintiffs have not alleged that Houston Harbaugh was retained for any purpose other than to render an opinion on record title. Therefore, Houston Harbaugh only had a duty to investigate and report matters of public record in the chain of title which may affect marketability. Houston Harbaugh fulfilled its duty by providing a title opinion related to the marketability of property, based on an examination of the public records of Butler County, Pennsylvania. Houston Harbaugh had no duty to provide information about who owned the property before Tulesbond, the relationship between Tulesbond and the partnerships, and how much the prior owners paid for the mineral rights, as they are not relevant to the state of title of the property. For this reason, the court holds that—assuming the facts as pled to be true—Houston Harbaugh did not omit any facts necessary to make its statements "not misleading."

Plaintiffs ask the court to equate this situation with those cases which have found accountants liable under § 10(b) even though their statements comported with generally accepted accounting principles. However, in those cases, the courts found the accountants' statements, while technically accurate, gave a false impression of the financial health of the company. *See e.g. In re Com. Oil/Tesoro Petroleum Corp. Sec. Lit.*, 467 F. Supp. 227 (W.D.Tex.1979); *Marx v. Computer Sciences Corp.*, 507 F.2d 485, 492 n.12 (9th Cir.1974). Thus, their financial statements were fundamentally misleading. Here, by contrast, the omitted statements would not have provided plaintiffs with any information about the state of title of the property, or about the partnerships' ability to purchase the desired mineral interests. The court is unwilling to extend the theory of liability under 10b-5 to include the responsibility for the issuers of title opinions to provide information well beyond facts relating to

the subject matter of the opinion. To hold under these facts that Houston Harbaugh had a duty to provide information beyond record title would place an intolerable burden on those rendering title opinions. Because Houston Harbaugh fulfilled its title examiner's obligation to report matters in the chain of title which may affect marketability, the court dismisses with prejudice plaintiffs' claim against Houston Harbaugh.

The Petrotec Entities have moved to dismiss the § 10(b) allegations against them on the grounds that plaintiffs failed to specify whether the claims were for primary or secondary liability. Paragraphs 54, 67, 79-80, and 86 of the complaint make clear that all Petrotec Entities except one (TexOil) are charged with primary liability. Therefore, this motion to dismiss is denied.

Defendant Baskin and Sears has also moved for dismissal. The complaint alleges Baskin and Sears prepared a materially false tax opinion which was included in the prospectus for the Boulder partnership in which plaintiff Bell invested in 1980. F.A.C. ¶ 9(a). This allegation is sufficient to state a claim under § 10(b). *See* May 21 Order, at p. 11; *Hudson v. Capital Management*, 565 F.Supp. 615 at 622 n. 3 (N.D.Cal.1983). For similar reasons, plaintiffs have also stated claims against defendants Technology Catalysts, and DiCicco (who prepared allegedly false reports included in the offering memoranda for the Drake 1981 and Dillon 1982 partnerships); against Somers and Altenbach (allegedly false tax opinion in same partnerships); against Fox and Company (allegedly false reports in the Boulder 1980 partnership); and against Lewin Energy and Kuuskraa (allegedly false reports in all partnerships in which the named plaintiffs invested).

Plaintiffs have also advanced claims for primary liability against other defendants who prepared allegedly false reports which were not included in the materials read by plaintiffs in connection with their investments. The court finds plaintiffs have failed to allege the requisite transactional nexus to state a claim for primary liability against these defendants. Therefore, the claims against defendants Doscher, CLD Group, Inc., Friedman and Shaftan, Schumacher and Hickey, and Frederick R. Schumaher, Ltd. are dismissed.

Plaintiffs have also failed to state claims for primary violations against defendants whose involvement in the partnerships was subsequent to plaintiffs' investments. For example, plaintiffs allege defendant Pyles is liable as a principal violator for his work on behalf of American Energy Resources in 1983. The court's ruling concerning the separate purchase issue makes this allegation a futile one. As no plaintiff purchased a security after 1982, no defendant whose involvement followed that date can be liable for primary or secondary liability under § 10(b). One can not be responsible for committing or assisting a fraud which has already occurred. *Hudson III*, 565 F.Supp. at 622 n. 3; *Mendelsohn v. Capital Underwriters Inc.*, 490 F.Supp. 1069, 1086 (N.D.Cal.1979). This reasoning also applies to the claim of a primary violation by Peat, Marwick. Plaintiffs' allegations of a principal violation of § 10(b) are based on financial reports issued after plaintiffs purchased their units. Therefore, plaintiffs' primary claims against Pyles and Peat, Marwick are dismissed. Plaintiffs' allegations of these defendants' liability as aiders and abettors and as conspirators are discussed *infra*.

2. Aiding and Abetting Liability

Plaintiffs have also advanced claims against a multitude of defendants for aiding and abetting the primary fraud under § 10(b). The elements of this claim are (a) the existence of a primary fraud; (b) actual knowledge by the aider and abettor of the fraud; and (c) "substantial assistance" in the perpetration of the fraud. *Harmsen v. Smith*, 693 F.2d 932, 943 (9th Cir.1982), *cert. denied*, 464 U.S. 822, 104 S.Ct. 89, 78 L.Ed.2d 97 (1983). Applying this standard to the claims against each defendant compels the court to dismiss some claims and to allow others to go forward.

Many of these aiding and abetting claims are asserted against defendants for their involvement in partnerships in which no named plaintiff invested. For example, plaintiffs advance claims against Baskin and Sears, Schumacher and Hickey, Frederick Schumacher, Ltd., and Somers and Altenbach for providing tax assistance letters included in the offering papers for partnerships in which no named plaintiff owns a unit. In a

similar vein, plaintiffs assert Fox and Co. may be liable for providing tax opinions for the Wichita partnerships memoranda and claim defendant Taylor may be liable for the acts he performed for the corporate general partner of the Wichita partnerships. The court finds these acts to be too attenuated from plaintiffs' injuries to provide the transactional nexus for an aiding and abetting claim.[6]

Plaintiffs have also asserted a claim against one law firm—Friedman and Shaftan—which provided a tax assistance letter included in the Boulder '80 offering memorandum. Plaintiffs allege this defendant knew from its prior tax opinions that the tax aspects of the investment were invalid and aided and abetted the fraud by failing to disclose this fact. The court does not agree. Although the Ninth Circuit has expanded the scope of aiding and abetting to include liability for remaining silent in some circumstances, a law firm in Friedman and Shaftan's position only has a duty to disclose when it provides "knowing assistance or participation in a fraudulent scheme."[7] *Strong v. France*, 474 F.2d 747, 752 (9th Cir.1973). The court finds that mere agreement by a law firm to defend a partnership in a tax conflict does not amount to knowing participation in the fraud. In the absence of allegations of more substantial participation, Friedman and Shaftan cannot be liable for its failure to whistleblow. *See Hudson III*, at 623-24.

Plaintiffs further allege Peat, Marwick is liable for aiding and abetting by virtue of its consent to the inclusion of its name in the confidential memoranda read by plaintiffs Roberts,

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6 Plaintiffs argue their claim of conspiracy provides the requisite connection. While an adequate conspiracy claim may keep a defendant in the case, it will not provide the transactional nexus needed to state a claim for aiding and abetting. Analysis of a claim of conspiracy is distinct from review of a claim of aiding and abetting. Although conspiracy is not an independent tort, *Halberstam v. Welch*, 705 F.2d 472, 479 (D.C.Cir.1983), successful proof of conspiracy will make a defendant vicariously liable for the fraud. Nevertheless, an allegation of conspiracy may not serve as a "bootstrap" method of demonstrating a transactional nexus sufficient to stating a claim for aiding and abetting. (The conspiracy allegations are discussed *infra*.)

7 The other two methods identified for establishing a duty to disclose—i.e., possession of inside information and consent of a director, *Strong v. France*, *supra*,—do not apply to Friedman and Shaftan.

Gauss and Delk. The offering documents for each Denver partnership stated that Peat, Marwick had agreed to perform accounting services for the partnership. ¶ 17(a). As with the tax assistance letters discussed above, mere agreement to provide accounting services in the future does not amount to substantial assistance in the fraud. Unlike the one of the law firm defendants in *Morgan v. Prudential Group, Inc.*, 81 F.R.D. 418 (S.D.N.Y.1978), Peat, Marwick did not issue a tax opinion or a financial statement and then allow the promoters of the partnership to refer to this opinion in the offering memoranda. *Id.* at 425 n.6. The court will not expand the scope of § 10(b) liability to encompass professionals whose involvement in the perpetration of the alleged fraud was merely agreeing to provide professional services in the future.

Plaintiffs have stated a claim for aiding and abetting against Somers and Altenbach for rendering securities advice to the Denver partnerships. Plaintiffs allege defendant knowingly gave false advice to the partnerships when it opined that the Denver partnerships were not integrated and did not need to be registered. A finder of fact could conclude this amounted to substantial assistance in the fraud. Defendant argues plaintiffs have failed to plead facts from which scienter can be inferred. Plaintiffs have pled that Somers and Altenbach's opinion was wrong and have alleged defendant knew of the falsity at the time it issued the opinion. As the remaining facts concerning scienter are within the possession of defendant, the court finds plaintiffs have plead enough to survive a motion to dismiss. This claim may be subject to an early motion for summary judgment if defendant can show the opinion was not false, or if it can demonstrate it did not know of its falsity at the time of issuance.

Plaintiffs have also successfully stated a claim against defendant Conklin. Conklin is alleged to have served as Heim's agent in this country; to have served as an officer in the technology licensing companies and served as escrow agent for collection of their fees; and to have managed the affairs of Tulesbond, Ltd., and other Petrotec companies. Plaintiffs claim Conklin knew the EQR technology was worthless because of his role as an officer of Elektra and Hemisphere. These allegations are suffi-

cient to suggest Conklin may have substantially assisted the primary fraud.

Defendant TexOil complains that it cannot tell from the complaint whether it is charged with primary or secondary liability. As the complaint clearly indicates plaintiffs are advancing a claim for aiding and abetting against TexOil, Complaint ¶ 67, its motion to dismiss is denied.

Two technology consultants, CLD Group and Lewin and Associates, have also moved to dismiss the aiding and abetting claims against them. Plaintiffs claim CLD is liable for "providing its purported expertise in EOR technology to the partnerships syndicated in 1981-2" and for the appearance of CLD's name in the partnership memoranda as a consultant on the use of additives for oil recovery when CLD "knew" this technology was "commercially infeasible." Complaint ¶ 63(b). These allegations are not sufficient to state a claim for aiding and abetting.

Plaintiffs do not allege CLD consented to the inclusion of its name in the partnership memoranda, nor do they suggest the partnerships relied on any advice by CLD when making representations about the commercial feasibility of the technology. The court has already cautioned plaintiffs that the mere "provision of information" does not create liability for aiding and abetting. May 21 Order, p. 13-14. The allegation that CLD provided "expertise" to the partnerships is similarly infirm absent elaboration on how this expertise helped cause the fraud against plaintiffs. Therefore, the aiding and abetting claim against CLD is dismissed with prejudice.

In contrast, Lewin and Associates ("L & A") is alleged to have provided the technical expertise on EOR which was used to prepare false reports on the geologic and financial aspects of the partnerships. Complaint ¶ 65(b). These reports were included in the memoranda for each partnership in which the named plaintiffs invested. Plaintiffs claim L & A knew this technology was ineffective and nevertheless assisted its subsidiary, Lewin Energy, in preparing these reports. A finder of fact could find this constituted substantial assistance. L & A argues plaintiffs failed to allege scienter adequately. However, plaintiffs have alleged L & A knew both that the technology was not

effective and that the reports were to be included in the offering memoranda for the partnerships. The court finds these allegations are sufficient to suggest L & A knew of the fraud to be perpetrated on the investors.

3. Conspiracy Allegations

In the Third Amended Complaint, plaintiffs alleged that all defendants had conspired to defraud them under § 10(b). In the Order of May 21, the court dismissed this claim under Fed.R. Civ.Pro. 9(b) for lack of particularity. The Order instructed plaintiffs to provide as much detail as possible about the nature of the conspiracy, what each defendant did in furtherance, and how and when each defendant agreed to join the conspiracy. Order, at 4-5. Although the court recognized that a claim of conspiracy is not an independent tort and does not itself give rise to a cause of action, *Halberstam v. Welch*, 705 F.2d 472, 479 (D.C.Cir.1983), the court required plaintiffs to plead the conspiracy charge separately from the underlying fraud to aid analysis of the charge.

To state a claim for conspiracy, plaintiffs must plead an agreement to participate in an unlawful act and an injury caused by an unlawful overt act performed in furtherance of the agreement. *Id.* at 477. By stating a claim under § 10(b), plaintiffs have clearly alleged an injury caused by an unlawful act. Defendants claim, however, that plaintiffs have failed to allege with specificity that all defendants agreed to participate in the scheme to defraud.

Proof of a conspiracy does not require a showing of an explicit agreement; a demonstration of a tacit agreement is enough. *Halberstam v. Welch*, 705 F.2d at 477. The existence of this agreement may be either express or inferred from a defendant's conduct. *Gilbert v. Bagley*, 492 F.Supp. 714, 727 (M.D.N.C.1980). This rule applies to pleading claims of conspiracy as well. *Rich-Taubman Associates v. Stamford Restaurant*, 587 F.Supp. 875, 879 n.5 (S.D.N.Y.1984); *First Federal Savings and Loan v. Oppenheim, Appel, Dixon & Co.*, 629 F.Supp. 427, 433-44 (S.D.N.Y.1986). However, "[t]o survive a motion to dismiss, plaintiff[s] must allege with sufficient fac-

tual particularity that [defendants] reached some explicit or tacit understanding or agreement. . . . It is not enough to show that [defendants] might have had a common goal unless there is a factually specific allegation that they directed themselves towards this [wrongful goal] by virtue of a mutual understanding or agreement." *Hauptmann v. Wilentz*, 570 F.Supp. 351, 382 (D.N.J.1983) (citing, *inter alia*, *Tarkowski v. Bartlett Realty*, 644 F.2d 1204, 1206 (7th Cir.1980); *Slotnick v. Staviskey*, 560 F.2d 31 (1st Cir.1977), *cert. denied*, 434 U.S. 1077, 98 S.Ct. 1268, 55 L.Ed.2d 783 (1978)).

Plaintiffs assert they have explicitly alleged defendants' agreement to participate in the conspiracy. Paragraph 76 of the complaint alleges each defendant "knowingly and willfully joined together in a conspiracy to defraud purchasers of interests in the [partnerships.]" Paragraph 5 contains similar language. These allegations, by themselves, are not sufficiently particular to satisfy the requirements of Rule 9(b); they are conclusory claims of agreement similar to the allegations previously rejected by this court. *See, e.g., Hudson I*, at 99,895. The court's prior order made clear that when, as here, plaintiffs plead on information and belief, they must set forth a statement of facts on which this belief is founded. Order, 4-5. When facts corroborating this belief are in the exclusive possession of defendants, plaintiffs were directed to indicate this. *Id.*

Plaintiffs argue they have complied with the terms of this court's order and have alleged sufficient facts about each defendant's participation in the conspiracy to satisfy the liberal rules of federal pleading. The court agrees that for many defendants the Fourth Amended Complaint adequately alleges facts demonstrating an agreement to conspire; for other defendants, however, the complaint does not meet the strictures of Rule 9(b).

The greatest shortcoming in pleading the conspiracy concerns the allegations against the professional defendants. Plaintiffs have advanced conspiracy claims against most of the professionals associated with the partnerships. As discussed above,

the named plaintiffs are unable to assert valid claims for primary liability or for aiding and abetting the fraud against those defendants not involved with the partnerships in which they invested. Plaintiffs therefore seek to maintain causes of action under § 10(b) against these defendants by asserting they conspired with others to defraud plaintiffs.

The allegations against these professional defendants are similar to one another. In each case, the defendant is alleged to have reached an agreement with the general partner to provide professional services to the partnership. Plaintiffs then state, "the dates and details of the meetings leading up to the agreement, as well as the terms of the agreement itself, are unknown to plaintiffs but are within the knowledge of defendants." Each defendant is then alleged to have done an act in furtherance of the conspiracy. The acts performed by each defendant typically involved issuing a false opinion, or misleading projection. See, e.g., Complaint, ¶ 83(a), 87(a-d), 89(a-f).

These allegations are deficient as they do not assert with the requisite particularity that defendants agreed to participate in a wrongful act. Plaintiffs allege each defendant agreed to provide professional services and "thereafter" performed a wrongful act in furtherance of the conspiracy. These allegations suggest the professional defendants did reach some agreement with the general partners, but they do not suggest the defendants reached an understanding to conduct an illegal scheme to defraud.

Plaintiffs assert these allegations create an inference that the professional defendants reached an agreement to perform a wrongful act. While a conspiracy claim may survive a motion to dismiss if it includes sufficient facts to support an inference of agreement, *Rich-Taubman*, *supra*, the factual allegations in this complaint do not support such an inference. Plaintiffs' claim that each professional defendant performed a wrongful act cannot, by itself, create an inference of a conspiratorial agreement. To allow a claim to go forward on this allegation alone would conflate the second element of a conspiracy claim—the act done in furtherance—into the agreement element.[8]

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8 Plaintiffs also do not allege that any of the professional defendants had an interest in the success of the partnerships or would derive any benefit

(*footnote continued on following page*)

Moreover, for those professional defendants who serviced the Wichita partnerships, the facts alleged do not suggest they "agreed" to participate in any scheme which involved the Denver or Manhattan partnerships. Plaintiffs allege each of these defendants was approached by defendant Krause, the general partner of the Wichita partnerships. Complaint, ¶ 89. None of the facts alleged support an inference that the "Wichita" professional defendants reached any kind of understanding with regard to the partnerships in which the named plaintiffs invested. The absence of this allegation makes the named plaintiffs' claims against these "remote" defendants extremely attenuated.

The court recognizes that "great leeway should be allowed the pleader" of a conspiracy since the details are often in the hands of the defendants. 2A J. Moore, *Moore's Federal Practice*, ¶ 8.17[5] at 8-125 (2d Ed.1985). Nevertheless, the court is unwilling to allow a broadly painted allegation of worldwide conspiracy to serve as the only mechanism for keeping professional defendants in a lawsuit based on fraud. The Ninth Circuit recently cautioned courts against allowing claims of fraud to go forward without sufficiently particular factual allegations, "especially [against] professional defendants whose reputations in their fields of expertise are most sensitive to slander." *Semegan v. Weidner*, 780 F.2d 727, 731 (1985).

The cases cited by plaintiffs as examples of successful conspiracy allegations differ significantly from the complaint before the court. *Hirt v. UM Leasing Corp.*, 614 F.Supp. 1066 (D.C.Neb.1985), for example, did not involve the issue raised here; the pleading deficiencies asserted by defendants did not address the question of agreement. *Id.* at 1070. In *Whitbread (US) Holdings v. Rothschild*, 630 F.Supp. 972 (S.D.N.Y.1986), the complaint specifically identified the joint venture agreement entered into by the alleged conspirators. *Id.* at 974, 983. And in those cases where the courts allowed a conspiracy allegation to go forward, the alleged scheme involved a relatively modest

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from the success of the alleged fraud. The absence of this allegation removes much of the force from plaintiffs' argument concerning the alleged conspiratorial agreement of the professional defendants.

number of actors, all of whom were directly involved in the tortious activity. *See, e.g., Rich-Taubman, supra, First Fed. Savings and Loan, supra.* Here, plaintiffs have advanced conspiracy claims against a multitude of professional defendants whose alleged involvement in the conspiracy came in partnerships in which no named plaintiff invested.

Under these circumstances, in light of the Ninth Circuit's admonition in *Semegan*, and because of the absence of factually specific allegations of agreement, the court hereby dismisses with prejudice the conspiracy claims against the professional defendants involved in partnerships in which the named plaintiffs have not invested, namely Schumacher & Hickey, and Frederick Schumacher, Ltd. For similar reasons, the court dismisses with prejudice the conspiracy claims against Houston Harbaugh, Peat, Marwick, the CLD Group, Taylor, Doscher, The Doscher Group, Inc., Case Engineering, and Friedman and Shaftan. The court also dismisses the conspiracy claims against Baskin and Sears, Lewin & Associates, Lewin Energy, DiCicco, Kuuskraa, Technology Catalysts, Fox & Co., TexOil, Robert Altenbach and Somers and Altenbach; however, these claims are dismissed without prejudice to renewal if further discovery permits plaintiffs to allege agreement with more particularity.[9]

Plaintiffs have also alleged that certain individual defendants conspired to defraud under § 10(b). Many of these defendants were involved with the corporate general partners for the partnerships and with the technology licensing firms Elektra/Hemisphere.[10] Given the nature of the responsibilities each

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9 Plaintiffs have already stated cognizable claims against these defendants for primary violations or for aiding and abetting. One of the Ninth Circuit's main concerns in *Segeman* was to prevent the use of discovery against professional defendants "as a pretext for the discovery of unknown wrongs." *Segeman*, 780 F.2d at 731. As these defendants will already be subject to discovery, dismissing the claims against them without prejudice will not burden them in any fashion. If plaintiffs discover additional evidence of a conspiratorial agreement while pursuing their other § 10(b) claims, they will be permitted to assert them if no prejudice to defendants ensues.

10 This includes defendants Bogdan, Rogen, Pyles, Cunningham, LaGuardia, Conklin and McCullough.

defendant carried with these firms, and in light of the alleged involvement these firms had with the organization and operation of the purported scheme, the court finds plaintiffs have successfully plead a claim of conspiracy against defendants Heim, Hilpert, Savery, Conklin, Basile, Coppage, Rogen, Bogdan, Cunningham, LaGuardia, McCullough and Pyles. The court also finds plaintiffs' conspiracy claims may go forward against the Manhattan and Denver partnerships, the Petrotec Systems, Inc., Petrotec Marketing Corporation, Petrotec Development and Production, Ltd., Elektra Energy Corporation, Hemisphere Licensing Corporation, Petroleum Sciences, Inc., GEDCO, American Energy Resources, AER Investments, Inc., and Forsee Group, Ltd.

The court did not receive motions to dismiss from defendants Krause and Energy Associates. No named plaintiff invested in any partnership in which these defendants were involved. However, as plaintiffs allege these defendants were recruited by the principals of the conspiracy, and as these defendants were responsible for the organization of the Wichita partnerships and thus were most familiar with the activities of all participants, the court will not dismiss the conspiracy claims against them *sua sponte*. Finally, the court did not receive motions to dismiss from defendants Puhar, Fiechter, the Wichita partnerships and the remaining Petrotec entities. The court will also not dismiss the conspiracy claims against these defendants *sua sponte*.

E. *"Control" Claims Under § 15 and § 20*

1. Section 20(a) of the Securities Exchange Act

Plaintiffs have advanced claims under § 20(a) of the 1934 Act against Heim, Savery, Hilpert, the technology licensors (Elektra/Hemisphere) and a variety of individuals associated with the operations of the partnerships. The court will discuss each of these claims in turn.

Plaintiffs allege each of these defendants controlled the activities of persons who violated § 10(b). "The term 'control' means the possession, direct or indirect, of the power to direct or cause the direction or management and policies of a person,

whether through the ownership of voting securities, by contract, or otherwise." 17 C.F.R. § 230.405 (cited with approval in *Safeway Portland Employees Federal Credit Union v. C.H. Wagner & Co.*, 501 F.2d 1120, 1124 n. 17 (9th Cir.1974).

The court's prior rulings in this order compel the dismissal of this cause of action against some defendants. Defendants Krause and Taylor, for example, cannot be liable for control violations associated with the Wichita partnerships since the court has dismissed the primary liability claims associated with these partnerships. In a similar vein, defendant Pyles cannot be liable for controlling violations which occurred before his association with AER.

In the May 21 Order, the court held that plaintiffs had stated a claim against defendants Heim and Savery but dismissed the claims against the Petrotec Entities with instructions to identify how each Petrotec Company exercises control. Plaintiffs now limit their control claims to the Petrotec technology licensors. Plaintiffs assert that since Heim and Savery controlled both the partnerships and Elektra/Hemisphere, and since Elektra/Hemisphere existed solely "to license purported EOR technologies to the partnerships and serve as the vehicles by which substantial sums of money were misappropriated . . ." (¶ 108), Elektra/Hemisphere are subject to control person liability as well. The court does not agree. The fact that Heim and Savery may have controlled both the partnerships and the licensors does not mean that the licensors therefore also controlled the partnerships. Moreover, the other allegations in the complaint do not support the bald allegation of control asserted in this cause of action. Plaintiffs have not alleged what relationship (*e.g.*, stock ownership, contract or other) gave the licensors control over the partnerships. For these reasons, the court dismisses the § 20(a) claims against Elektra Oil, Elektra Energy, Hemisphere and Petrotec Systems.

Plaintiffs have also alleged defendant Rogen is liable for control violations by virtue of his role in Elektra Energy, Hemisphere, and Petroleum Sciences. The claim against defendants Hilpert and Conklin are based on their roles as officers in Elektra/Hemisphere and Petrotec Systems. In light of the

above ruling concerning the licensors, the claims against Rogen, Hilpert and Conklin are dismissed as well.

Plaintiffs have stated a claim against defendants Basile and Coppage, the individual general partners for the Manhattan and Denver partnerships. Plaintiffs have also alleged sufficient detail concerning the activities of the officers of AER to state a claim against them.

2. Section 15 of the Securities Act

Section 15 of the Securities Act imposes secondary liability upon those who controlled the activities of persons who violated § 12. As only plaintiff Gauss has stated a claim under § 12, the § 15 cause of action is dismissed against defendant Basile as well as the other defendants identified above.

F. *Pendent State Claims*

Plaintiffs have advanced a variety of state statutory and common law claims. As the court has dismissed the federal claims against several defendants, there is no jurisdiction to bring the state claims against these defendants. *United Mine Workers v. Gibbs*, 383 U.S. 715, 86 S.Ct. 1130, 16 L.Ed.2d 218 (1966). The court therefore dismisses the pendent claims against defendants Taylor, Doscher, CLD Group, the Doscher Group, Case Engineering, Schumacher & Hickey, Frederick Schumacher Ltd., Houston Harbaugh, Friedman and Shaftan, and Peat, Marwick. The court will next consider each of the remaining state law issues raised by defendants.

1. Professional Malpractice

Lewin and Associates assert they cannot be liable for malpractice as they did not author any opinion contained in the offering circulars. Plaintiffs concede that only authors can be liable for malpractice. They assert, however, that Lewin and Associates is liable for the CLD Group opinion signed by defendant Kuuskraa, vice president of Lewin and Associates. This opinion appeared in the offering memorandum for partnerships in which no named plaintiff invested and thus cannot serve as

the basis for a malpractice claim. Plaintiffs also assert Lewin and Associates is liable for other opinions authored by CLD Group which were read by plaintiffs in connection with their investments. Plaintiffs have cited no authority for the proposition that Lewin and Associates' partial ownership of CLD Group, Inc. can make Lewin liable for CLD's professional malpractice. As a result, the court dismisses the malpractice claim against Lewin and Associates.

2. California Corporations Law Claims

Several defendants have also attacked the sufficiency of plaintiffs claims under California securities laws. Lewin and Associates claim they cannot be liable under Cal.Corp.Code § 25504.2 because they did not author an opinion read by the named plaintiffs. For the reasons stated above, the court dismisses this claim against Lewin and Associates.

The claim that defendant Pyles violated § 25504 and § 25504.1 is also dismissed. Pyles joined AER after all of the named plaintiffs had purchased their securities and therefore cannot be liable for aiding and abetting or for control violations.

Defendant Rogen has moved to dismiss the claim against him under § 25502 for control violation. For the reasons discussed *infra*, the court finds Rogen cannot be liable under § 25504. Plaintiffs' claims under this section are limited to those defendants against whom plaintiffs have stated a cognizable claim under § 15 of the Securities Act.

Defendant Baskin and Sears moves to dismiss the § 25506.1 claim against it. The court finds the three year statute of limitations in this section to be an absolute limit not tolled by any allegations of fraudulent concealment. The plain language of the statute is similar to that of 15 U.S.C. § 77m and the analysis of this section above is equally applicable here. Therefore, this claim is dismissed.

3. Remaining Common Law Claims

Defendant Pyles also moves to dismiss the negligent misrepresentation claim. He argues that the statute requires a "posi-

tive assertion", while plaintiffs' claim is based on his alleged failure to come forward with information of the fraud. As plaintiffs have not alleged Pyles made any positive representations, the court finds he cannot be liable for negligent misrepresentation. *See Huber, Hunter & Nichols, Inc. v. Moore*, 67 Cal.App.3d 278, 304, 136 Cal.Rptr. 603 (1977).

Plaintiffs have also advanced a claim under a common law theory of fraud and deceit. The court dismissed with prejudice a very similar claim entitled "knowing and reckless misrepresentation" in the Third Amended Complaint. After reconsidering the grounds for dismissing the earlier claim, the court finds plaintiffs have stated a cognizable claim for fraud and deceit against all defendants upon whom plaintiffs relied in making their investments. Finally, the court finds that plaintiffs may go forward with the common law conspiracy claims against the defendants whom they've stated cognizable conspiracy claims under section 10(b).

III. CLASS CERTIFICATION

Plaintiffs seek certification of a class defined as "[a]ll persons, except defendants, who purchased interests in any of the Oil Technology Group Partnerships . . . ." If certified, this class would include some 2,920 investors who purchased interests in any of the 40 Manhattan, Denver or Wichita partnerships.[11]

Defendants raise a general challenge to the propriety of certifying such a "global" class in this case. In addition, they raise specific challenges to the state law and separate purchase claims and the adequacy of particular named plaintiffs to represent the class.

A. *Requirements of Rule 23*

Under Fed.R.Civ.P. 23(a), plaintiffs must satisfy all of the following requirements before a class can be certified: 1)

11 It is not clear to the court exactly how many partnerships exist. Plaintiffs allege there are 40 partnerships. Defendants claim there are only 39. Until this matter is resolved, the court will assume plaintiffs' allegations are true, and presume 40 partnerships exist.

numerosity—the class must be so numerous that joinder of all members is impracticable; 2) commonality—there must be questions of law or fact common to the class; 3) typicality—the claims or defenses of the representative parties must be typical of the claims or defenses of the class; and 4) adequacy—the representative parties must fairly and adequately protect the interests of the class.

In addition, plaintiffs must satisfy one of the elements of Rule 23(b). Here plaintiffs seek to certify a class under Rule 23(b)(3), which requires that the court find that "questions of law or fact common to the members of the class predominate over questions affecting only individual members, and that a class action is superior to other available methods for the fair and efficient adjudication of the controversy."

Before addressing each of these requirements, a few initial observations are appropriate. The Ninth Circuit and the Northern District in particular have taken a liberal view of class certification in securities litigation. *See, e.g., Blackie v. Barrack*, 524 F.2d 891, 903 (9th Cir.1975), *cert. denied*, 429 U.S. 816, 97 S.Ct. 57, 50 L.Ed.2d 75 (1976); *In Re Activision Securities Litigation*, 621 F.Supp. 415, 428 (N.D.Cal.1985). Further, in determining whether to certify this class, this court must only determine whether the prerequisites of Rule 23 have been met. Indeed, "[t]he question [on class certification] is not whether the . . . plaintiffs have stated a cause of action or will prevail on the merits, but rather whether the requirements of Rule 23 are met." *Eisen v. Carlisle & Jacquelin*, 417 U.S. 156, 178, 94 S.Ct. 2140, 2153, 40 L.Ed.2d 732 (1974), *quoting with approval, Miller v. Mackey International, Inc.*, 452 F.2d 424, 429 (5th Cir.1971).

B. *Requirements of Rule 23(a)*

1. Numerosity

The first prong under Rule 23(a) requires that the class be sufficiently numerous that joinder of all class members is impracticable. This action involves some 2,920 members who purchased interests in the Manhattan, Denver or Wichita part-

nerships. Since the size of this proposed class is so numerous that joinder would be impracticable, the court finds the numerosity requirement is satisfied.

2. Commonality

The second requirement of Rule 23(a) is that the class members must have questions of law or fact in common. Plaintiffs claim the commonality requirement is met for two reasons. First, the complaint delineates a conspiracy, concerted scheme and common course of conduct. Second, all of the Oil Technology Group Partnership interests are alleged to have been offered and sold pursuant to substantially similar offering memoranda, which contained the identical omissions and misrepresentations of material facts. Each offering memoranda is alleged to omit and/or misrepresent the following material facts: 1) that Heim, Savery and the so-called independent technology licensors not only formulated the idea for the creation of the partnerships, but actually controlled the partnerships' operations, including the terms of partnership contracts and the identity of partnership consultants; 2) that the represented EOR technologies either did not exist or were known to be commercially infeasible in light of the excessive license fees paid by the partnerships for their use; 3) that the tax deductions promised to the investors could not be obtained; and 4) that each of the partnerships was part of a single plan of financing and would not conduct its own business and maintain its own books and records. Despite the fact each of the 40 partnerships put out separate partnership offerings over a 5-year period involving different written materials and different groups of defendants, plaintiffs claim common questions of law and fact exist for all members of the class because of these common alleged misrepresentations and omissions.

To support the commonality requirement, plaintiffs rely on *Blackie v. Barrack*, 524 F.2d 891 (9th Cir.1975), and *Harris v. Palm Springs Alpine Estates, Inc.*, 329 F.2d 909 (9th Cir.1964). In both of these cases different representations at different times were made to investors. Yet, in *Blackie*, because plaintiffs alleged a "common course of conduct" of substantially similar

omissions and misrepresentations which allegedly affected all the class members in the same manner, the Ninth Circuit found the common question requirement was satisfied. *Blackie, supra*, 524 F.2d at 902-03. Similarly, in *Harris*, since the complaint alleged a conspiracy or common course of conduct by means of false statements and material omissions, the court found the commonality requirement was met. *Harris, supra*, 329 F.2d at 914-15. As plaintiffs allege a conspiracy, concerted scheme and common course of conduct of substantially similar omissions and misrepresentations, which allegedly affected all the class members in the same manner, the court finds plaintiffs have met the commonality requirement under the standard set forth in *Blackie* and *Harris*.

While the court finds the class members' claims involve common questions of law and fact, the court notes that each of the aforementioned omissions and misrepresentations alleged by plaintiffs assumes the existence of a conspiracy or concerted scheme. As mentioned above, in determining class certification, the court must not consider the merits of the underlying action, *Eisen v. Carlisle-Jacquelin*, 417 U.S. 156, 178, 94 S.Ct. 2140, 2153, 40 L.Ed.2d 732 (1974); *Blackie v. Barrack*, 524 F.2d 891, 901 (9th Cir.1975), and thus must not now address the merits of plaintiffs' conspiracy allegations or of the alleged omissions and misrepresentations. Yet, in the ensuing stages of the litigation, the court will closely examine the merits of plaintiffs' conspiracy and concerted scheme allegations. In order to justify the continuation of this litigation with a "global" plaintiff class, plaintiffs must establish the basis for these allegations. If plaintiffs fail to establish the existence of a conspiracy or concerted scheme, and thus that the substantially similar offering memoranda contained the identical omissions and misrepresentations of fact, the court may be forced to decertify the class for failure to meet the commonality requirement.

3. Typicality

Under this third requirement of Rule 23(a), the named plaintiffs must present claims that are "typical" of the class. Plaintiffs claim the typicality requirement is met because the named

plaintiffs, like the other class members, were injured by purchasing the same unregistered securities pursuant to documents containing identical or substantially similar omissions and misrepresentations of material fact. Defendants claim that *La Mar v. H & B Novelty & Loan Co.*, 489 F.2d 461 (9th Cir.1973), prevents the named plaintiffs from proceeding on behalf of plaintiffs who invested in partnerships in which the named plaintiffs did not invest. In *La Mar*, the Ninth Circuit held that when the representative plaintiff does not have a claim against all defendants, a class may not be certified for failure to meet, among others, the typicality requirement. *La Mar*, *supra*, 489 F.2d at 465. Because in this case the named plaintiffs invested in only four limited partnerships, and yet are attempting to represent class members who invested in 40 different partnerships, defendants claim a global class should not be certified. The court does not agree.

In *La Mar*, the Ninth Circuit held that the typicality requirement is met even where the named plaintiffs did not deal directly with all defendants, provided a concerted scheme or conspiracy is alleged. *La Mar*, *supra*, 489 F.2d at 466. The court finds that plaintiffs' claims fall within each of the *La Mar* conspiracy and concerted scheme exceptions. First, in the pending motions to dismiss this court held that plaintiffs have made adequate conspiracy allegations as to certain defendants. These allegations bring this case squarely within the conspiracy exception. Second, as plaintiffs have adequately alleged that the same omissions and misrepresentations of material fact infected all the offerings, these allegations fall within the *La Mar* concerted scheme exception.

As plaintiffs' claims fall within these *La Mar* exceptions, each plaintiff need not have a claim against each defendant in order to fulfill the typicality requirement. However, as was explained above, should plaintiff through discovery fail to establish the basis for the conspiracy or concerted scheme allegations, the court may be forced to decertify the class for failure to meet the typicality requirement.

4. Adequacy of Representation

The fourth prong of Rule 23(a) mandates that the plaintiffs must fairly and adequately protect the interests of the class.

Two criteria exist for determining the adequacy of representation of a class: first, counsel for the named class representative must have the competence to prosecute the litigation; and second, there can be no disabling conflicts between the interests of the named class representatives and the members of the class. *See Lerwill v. Inflight Motion Pictures, Inc.*, 582 F.2d 507, 512 (9th Cir.1978); *In re Victor Technologies Securities Litigation*, 102 F.R.D. 53, 62 (N.D.Cal.1984).

Defendants do not dispute the competence of counsel, and the court notes that class counsel for the plaintiffs have ample experience in bringing sophisticated securities fraud class action suits. Defendants do, however, claim a disabling conflict of interest exists between the named representatives and the absent class members who are asserting in United States Tax Court proceedings the validity of tax deductions taken on partnership investments. In addition, defendants challenge the adequacy of two of the named representatives, Jack Bell and Arthur Gauss.

First, the court is not persuaded by defendants' conflict of interest argument. Courts have long recognized the use of the "opt out" mechanism to ameliorate class conflicts. *See Siegel v. Chicken Delight, Inc.*, 271 F.Supp. 722 (N.D.Cal.1967), *rev'd on other grounds sub nom., Chicken Delight, Inc. v. Harris*, 412 F.2d 830 (9th Cir.1969); *Lerwill v. Inflight Motion Pictures, Inc.*, 582 F.2d 507 (9th Cir.1978); *Hudson v. Capital Management International, Inc.*, 565 F.Supp. 615 (N.D.Cal. 1983). Whatever the resolution of the U.S. Tax Court claims, if any potential conflict exists, it may be eliminated by individual class members' use of the opt-out mechanism provided under Rule 23(c)(2). If numerosity problems were to arise because so many class members exercised their opt-out right, the court could decertify the class at that time. *Hudson*, 565 F.Supp. at 631.

The court also finds plaintiffs Bell and Gauss should be certified as class representatives. Defendants argue Mr. Bell cannot be certified as a representative because 1) his professed disinterest in the tax advantages of the Boulder partnership makes him an inadequate and atypical representative; 2) he received advice from an investment advisor that differed from the representations made in the offering memorandum for Boulder, thus ren-

dering him inadequate and atypical; and 3) his rejection of the rescission offer, his attempt to remove Mr. Basile as individual general partner, and his meeting with the corporate general partner make his "individual motivations, investment desires and mitigation of damages individualized," thus rendering him inadequate and atypical.

The court is not persuaded by any of these challenges. None of the problems is so significant as to preclude Mr. Bell from acting as an adequate class representative. First, even if Mr. Bell's investment was not entirely tax related, his claim stems from the same event, practice or course of conduct and legal theory that forms the basis of the claims of all class members. Mr. Bell's relatively less emphasis on the tax advantages as a reason for investment does not render him an atypical or inadequate representative. *See Hudson v. Capital Management International, Inc.*, No. C-81-1737, slip op. at 20 (N.D.Cal. March 7, 1984) ("Hudson IV") [Available on WESTLAW, DCT database].

Second, even if Mr. Bell had received information from his investment advisor, the confidential memorandum itself stated that each limited partner should consult his personal attorney, accountant, and other advisors as to the legal, tax, economic and related aspects of the investment. Thus, Mr. Bell's reliance on an adviser renders him more typical than atypical. Moreover, the Ninth Circuit has held that a proposed class representative is not rendered atypical by virtue of reliance on third parties. *Keirnan v. Homeland, Inc.*, 611 F.2d 785, 789 (9th Cir.1980).

Finally, none of the circumstances involving Mr. Bell—his rejection of the recision offer, his effort to unseat Mr. Basile, and his meeting with a corporate general partner of the Boulder partnership—renders Mr. Bell atypical or inadequate. Plaintiffs and defendants agree on the factual background regarding Mr. Bell and the facts are as follows. Mr. Bell received an offer to rescind his investment in Boulder based on, *inter alia*, the formerly undisclosed fact that defendant Richard Basile, Boulder's individual general partner, had previously been sanctioned by the Securities and Exchange Commission (SEC). Upon learning of Mr. Basile's SEC sanctions, Mr. Bell, though rejecting the

rescission offer, attempted to unseat Mr. Basile as individual general partner. In addition, Mr. Bell visited Boulder's corporate general partner to apparently assure himself that the partnership's operations were proceeding according to plan.

First, the rescission offer directed to Mr. Bell was apparently also disseminated to the other investors in his partnership, thereby making Mr. Bell typical of all other investors. Moreover, the rescission offer does not affect Mr. Bell's typicality because his claims are based on omissions and misrepresentations of material fact that were not disclosed in the rescission offer. Second, Mr. Bell's effort to unseat Mr. Basile is irrelevant to the typicality of the claims arising from the confidential memoranda, because there was no disclosure of the facts underlying these claims at the time of his ouster activities. Finally, Mr. Bell's meeting with the corporate general partner is irrelevant because at that meeting Mr. Bell was advised that the partnership was operating as planned and was assured that Mr. Basile's conduct as general partner was proper.

In addition to claiming plaintiff Bell is an inadequate representative, defendants argue plaintiff Gauss cannot be certified as a class representative because contentions made on his behalf in a tax petition filed in the U.S. Tax Court create a disabling conflict of interest with the class members. But, as Judge Patel concluded in *Hudson IV*, a class representative who files a potentially contradictory tax petition need not be disqualified from acting as a class representative. *Hudson IV* at 19.

C. *Requirements of Rule 23(b)(3)*

Under Rule 23(b), once the four prerequisites of 23(a) have been met, the class to be certified must also qualify under one of the three provisions of Rule 23(b). In this action, plaintiffs seek certification under Rule 23(b)(3). Rule 23(b)(3) requires that the court find that common issues of law or fact predominate over individual issues, and that a class action is a superior form of adjudicating the dispute.

Plaintiffs claim that common questions of law and fact predominate over individual issues because all of the claims arise out of alleged omissions and misrepresentations of material fact

appearing in substantially similar offering documents. As mentioned above, the offering materials for each partnership are alleged to be misleading in the same respects.

Defendants assert that common questions of fact or law do not predominate for two primary reasons. First, there exist material variations in the representations made to investors, *i.e.*, that each of the 40 partnerships put out separate partnership offerings over a 5-year period involving different written materials and different groups of defendants. As such, defendants argue, the numerous individual differences overshadow the few common issues. Second, because proof of reliance is required, reliance is an individual issue predominating over any common issues.

The court finds common questions of law and fact do predominate over any questions affecting individual members: because plaintiffs allege the claimed omissions or misrepresentations of material fact are substantially similar for all investors, proof of liability as to one should constitute proof as to all. *Blackie v. Barrack*, 524 F.2d 891 (9th Cir.1975); *Harris v. Palm Springs Alpine Estates, Inc.*, 329 F.2d 909 (9th Cir.1964). This finding, however, is qualified by the court's previous message. Since the omissions and misrepresentations claimed by plaintiffs assume the existence of a conspiracy or concerted scheme, plaintiffs must establish the basis for the conspiracy or concerted scheme allegations. Should plaintiffs fail to substantiate these allegations, and thus that the substantially similar offering memoranda contained the identical omissions and misrepresentations of fact, the court will be forced to decertify the class for failure to meet the predominance requirement. For if no conspiracy or concerted scheme exists, the numerous differences in the representations made to investors would overshadow any common issues.

The court also finds that reliance is not a predominating individual issue. Where the complaint, as in this case, is based primarily on claims of misrepresentation and omission, courts presume reliance at the class certification stage. *Blackie v. Barrack*, 524 F.2d at 905-06; *Arthur Young & Company v. United States District Court*, 549 F.2d 686, 695 (9th Cir.1976), *cert. denied*, 434 U.S. 829, 98 S.Ct. 109, 54 L.Ed.2d 88 (1977).

Because individual reliance is presumed, common questions predominate over individual issues.[12]

Finally, the court finds that under Rule 23(b)(3) employing the class action device is the superior mode for adjudicating this case. Should unworkable manageability problems arise in the future, the court could decertify the class to provide for the fair and efficient adjudication of the case.

1. State Law Claims

a. Common Law Claims

In addition to the general objection to the certification of a global plaintiff class for failure to meet the predominance requirement, defendants specifically argue the state common law claims should not be certified because individual choice-of-law questions do not predominate over common questions. Citing the recent Supreme Court opinion, *Phillips Petroleum Co. v. Shutts*, 472 U.S. 797, 105 S.Ct. 2965, 86 L.Ed.2d 628 (1985), defendants assert this court could not constitutionally apply the law of any single state, including California, to all the class members' state law claims and, as a consequence, common issues of law or fact will not predominate over individual issues. In support of this contention, defendants note that the class members reside in some 37 states and 2 foreign countries, and that the relevant laws of these jurisdictions materially differ from those of California.

In *Harmsen v. Smith*, 693 F.2d 932, 946-47 (9th Cir.1982), *cert. denied*, the Ninth Circuit held that a district court addressing a conflict of law question for pendent securities claims is required to follow California choice-of-law rules. California has adopted the governmental interest approach to choice of law questions. *Nelson v. Tiffany Industries, Inc.*, 778 F.2d 533, 534 (9th Cir.1985). Under the three-part approach defined in

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12 Defendants specifically argue that plaintiffs' separate purchase claim raises individual reliance questions and thus should not be certified as a class action. The court granted Peat, Marwick's motion for partial summary judgment regarding plaintiffs' separate purchase claim, thus mooting the necessity for ruling on defendants' argument here.

Nelson and *Harmsen*, the burden is on the defendants to show: 1) a true conflict exists; 2) each state has an interest in applying its own law; and 3) if each state has such an interest, which state's interest would be more impaired should its law not be applied. *Harmsen v. Smith*, 693 F.2d at 946-47; *In re Activision Securities Litigation*, 621 F.Supp. 415, 431 (N.D.Cal.1985).

Defendants have shown that material differences do exist between California law and the law of the other states. However, they have failed to show why California law would not apply in this case. The courts of this district have presumed for class certification purposes that California law will apply when the defendants have not successfully argued prior to the class certification motion that, under California choice-of-law rules, the law of another jurisdiction will apply. *See Activision*, 621 F.Supp. at 430-31, *motion to reconsider class certification denied*, No. C-83-4639(A) MHP (N.D.Cal. Dec. 2, 1985) [Available on WESTLAW, DCT database]; *In re Diasonics Securities Litigation*, 599 F.Supp. 447, *motion for decertification denied*, No. C-83-4584 RFP (N.D.Cal. Feb. 26, 1986); *In re Pizza Time Theatre Securities Litigation*, 112 F.R.D. 15 (N.D.Cal. 1986); *In re Computer Memories Securities Litigation*, 111 F.R.D. 675 (N.D.Cal. Aug. 26, 1986). The court adopts this approach for this case. Defendants have not requested that this court apply the law of another jurisdiction, nor have they met their burden of showing that other states' interests would be more impaired than California's if the court were to use California law. Accordingly, this court will apply California law unless defendants can show the interest of other states in having their law followed is greater than California's interest in applying its own laws. If the defendants subsequently raise choice-of-law questions which render the common law claims inappropriate for class treatment, the court will consider a decertification motion at that time.

The court now turns to the question of whether California law may be constitutionally applied to the class members' common law claims. The Supreme Court's decision in *Phillips Petroleum Co. v. Shutts*, 472 U.S. 797, 105 S.Ct. 2965, 86 L.Ed.2d 628 (1985), provides the constitutional limitations on this Circuit's choice-of-law analysis. In *Shutts*, the court for-

mulated a two-step analysis for determining whether a state may constitutionally apply its law to all of the claims of a nationwide class. First, the district court must determine whether the forum state's law conflicts with any other state law which could apply. Second, if a conflict exists, the court must determine whether the forum has "a 'significant contact or aggregation of contacts' to the claims asserted by each member of the plaintiff class, contacts 'creating state interests in order to ensure that the choice of [forum] law is not arbitrary or unfair.' " *Id.* at 2980, *quoting in part Allstate Ins. Co. v. Hague*, 449 U.S. 302, 312-13, 101 S.Ct. 633, 640, 66 L.Ed.2d 521 (1981). In *Shutts*, approximately 28,000 royalty owners brought an action in Kansas state court to recover interest on their royalty payments. Because only 3% of the plaintiffs and roughly one-quarter of one percent of the leases involved in the lawsuit had any connection with the state of Kansas, the Supreme Court held the trial court's application of Kansas law to every claim in the case was arbitrary and unfair and thus exceeded constitutional limits. *Id.*

In this case the court finds "a significant contact or aggregation of contacts" to meet the requirements of *Shutts*. Plaintiffs allege the following contacts: 1) about 25% of all the limited partners in the Denver and Manhattan partnerships are residents in California; 2) eight of the Denver partnerships, the 1981-1983 partnerships, are headquartered in California; 3) the individual general partner of the 1981-1983 Denver partnerships resides in California; 4) during the period when the 1981-1982 Denver partnerships were initially offered and sold, the corporate general partner, American Energy Resources, Inc., maintained an office in California, from which it engaged in sales activities, including the dissemination of confidential memoranda; and 5) in 1985, the Manhattan and Denver partnerships engaged in a joint venture in California.

The foregoing allegations, if true, constitute a significant contact between California and the claims asserted by each of the class members such that application of California law in this case would be neither arbitrary nor unfair. The facts of this case are readily distinguishable from those in *Shutts*, in which the vast majority of class members had no contact with the forum

state. In this case, a plurality of class members, some 25% of 2,900 investors, have significant contacts with California.

Finally, contrary to defendants' contention, *Shutts* does not require the court to undertake an individual choice-of-law inquiry into the claims of each and every plaintiff. *In re Activision Securities Litigation*, *supra*, ¶ 92,397 at 92,440; *In re Computer Memories Securities Litigation*, 111 F.R.D. 675, *Order Granting Motions for Class Certification*, at p. 22. *Shutts* requires only that a threshold due process inquiry be made into whether the application of a given state's law to the claims of all class members would be arbitrary or unfair.

Accordingly, the court provisionally certifies plaintiffs' state common law claims. However, if at some later date defendants establish that the interests of other states outweigh California's interest in having its law applied to plaintiffs' common law claims, the court will have to determine which state law should be applied under California choice-of-law rules and whether, in light of that determination, class treatment would be unmanageable. In addition, the court notes that it has not engaged in extensive statistical analysis of all the plaintiff investors' and defendant entities' contacts to California. Until the defendants supply the court with a statistical analysis demonstrating why application of California law in this case would be arbitrary or unfair, on the basis of the facts now before the court, certification of the pendent state common law claims is proper.

b. State Statutory Claims

Finally, defendants argue that certification of a global class for the state statutory claims violates the statutory requirements of Cal.Corp.Code § 25008(b). They argue that the court should only permit certification of a class of California investors. The court agrees.

Cal.Corp.Code § 25008(b) in relevant part provides:

> An offer to sell or to buy is made in this state when the offer either originates from this state or is directed by the offeror to this state and received at the place to which it is directed. An offer to buy or sell is accepted in this state when acceptance is communicated to the offeror in this state . . . .

Hence, the jurisdictional prerequisites or § 25008(b) are satisfied when offers of securities are made from California to persons outside the state, or when acceptance of the offer is directed to a person within California. *See In re Victor Technologies Securities Litigation*, 102 F.R.D. 53, 60 (1984). Accordingly, the court certifies a class for the California Corporations Code claims of those who accepted an offer emanating from California or who purchased their partnership interests in California.

CONCLUSION

In accordance with the foregoing, the court provisionally certifies a "global" plaintiff class for the §§ 10(b), 12, 15, 20 and state common law claims. The court also certifies a class of California investors for the state statutory claims.

However, it should be clearly understood that the court is deeply concerned about certifying a class of this breadth. Only because plaintiffs have vigorously asserted the existence of a conspiracy or concerted scheme in this case, and because these allegations tie this class together, has the court provisionally certified a "global" class and allowed plaintiffs the opportunity to establish the basis for the conspiracy and/or concerted scheme allegations. The court is fully aware that civil conspiracy and/or concerted scheme is often difficult, if not impossible, to establish at the pleading stage.

Up to this time, discovery in this litigation has been limited to class certification issues and monitored by the previously appointed Special Master, Gerald Cohn. Because the conspiracy and concerted scheme allegations are the "glue" holding this global class together, logically the next stage of discovery must focus on plaintiffs establishing the basis for these allegations. The court hereby orders Special Master Cohn to closely monitor the discovery on this issue in whatever manner he deems appropriate. The Special Master shall report back to the court, at such times as he deems proper, as to whether in their discovery plaintiffs are merely engaging in a "fishing expedition" or making a legitimate effort to identify and establish a conspiracy or concerted scheme. Should the Special Master

report to the court plaintiffs are engaging in a fishing expedition, and that at the time plaintiffs' pleadings were submitted it was not reasonable to allege such a conspiracy and/or concerted scheme, the court will then consider ordering plaintiffs and/or their counsel to pay defendants' attorneys fees, costs and expenses incurred in this discovery, pursuant to Rule 11 of the Federal Rules of Civil Procedure.

If plaintiffs and their counsel are not willing to be subjected to the potential of Rule 11 sanctions on this issue, their alternative is to dismiss the conspiracy and concerted scheme allegations within 21 days of the date of this Order. Should plaintiffs dismiss the conspiracy and concerted scheme allegations, the court will take under submission the extent to which it should revise this Class Certification Order. If plaintiffs go forward with the conspiracy and concerted scheme claims, they shall present to the Special Master a written outline of their proposed discovery pertaining to the conspiracy and concerted scheme claims within 21 days of the date of this Order. Plaintiffs should also provide a copy of this outline to defendants. All future discovery in this case, by any party, may be taken pursuant only to orders made by the Special Master or the Court.

IV. MOTIONS FOR SANCTIONS

Defendant Peat Marwick moves to strike plaintiffs' class action allegations against it, and for sanctions under Rule 11. Plaintiffs oppose Peat Marwick's motion as well as cross-move for sanctions.

Peat Marwick claims that because plaintiffs made false allegations against it in order to support their separate purchase of securities claim, plaintiffs should be disqualified to serve as class representatives against it, and should be sanctioned under Rule 11. In the pending motions to dismiss and for summary judgment, the court dismissed Peat, Marwick from this lawsuit, thus mooting the necessity for ruling on Peat Marwick's motion to strike plaintiffs' class allegations against it. In addition, the court denies Peat Marwick's motion for sanctions. Even if Peat Marwick were correct in asserting that plaintiffs performed an

inadequate factual investigation regarding certain allegations, Rule 11 sanctions would be improper because no showing can be made that plaintiffs' "pleading, motion or other paper" itself was frivolous or not well-grounded in fact or law. *See Golden Eagle Distributing Corporation v. Burroughs Corporation*, 801 F.2d 1531 (9th Cir.Oct.9,1986). While this court granted Peat Marwick's motion for partial summary judgment on plaintiffs' separate purchase claim, plaintiffs did establish a cognizable basis for their separate purchase claim against Peat Marwick. Since plaintiff's pleading against Peat Marwick was not frivolous, the court finds no Rule 11 violations.

Finally, the court denies plaintiffs' cross-motion for sanctions. Contrary to plaintiffs' arguments, Peat Marwick's motion for sanctions was not frivolous, and thus Peat Marwick and its counsel are not subject to Rule 11 sanctions.

V. SUMMARY

For all of the reasons detailed above, and good cause appearing, the court hereby orders that:

1. Defendants' motion for partial summary judgment on the promissory note issue is GRANTED. Plaintiffs' payments on the promissory notes did not constitute separate investment decisions; and

2. Defendants' motion to dismiss the RICO claim is GRANTED; and

3. Defendants' motion to dismiss the claim under Section 17(a) of the Securities Act of 1933 is GRANTED; and

4. Defendants' motion to dismiss the claims advanced by plaintiffs Roberts, Delk, and Bell under Section 12 of the 1933 Act is GRANTED; and

5. Plaintiff Gauss' claim under Section 12 may go forward against defendants Heim, Hilpert, Savery, American Energy Resources and Dillon '82; his Section 12 claims against the remaining defendants are DISMISSED; and

6. Plaintiffs' claims of primary liability under Section 10(b) are DISMISSED against defendants Houston-Harbaugh, Friedman and Shaftan, Schumacher and Hickey, Frederick R. Schumacher, Ltd., Todd Michael Doscher, The Doscher Group, Inc., CLD Group, Inc., Pyles, Krause and Peat, Marwick; plaintiffs' claims against defendants Heim, Savery, Coppage, Basile, Rogen, Hilpert, Bogdan, Cunningham, Lewin Energy, Kuuskraa, Technology Catalysts, DiCicco, Fox & Co., Somers and Altenbach, Robert Altenbach, Baskin and Sears, and the Petrotec Entities may go forward; and

7. Plaintiffs' claims of aiding and abetting under Section 10(b) are DISMISSED against defendants Peat, Marwick, Fox & Co., the CLD Group, Inc., Taylor, Baskin and Sears, Friedman and Shaftan, Schumacher and Hickey, and Frederick Schumacher, Ltd.; plaintiffs' aiding and abetting claims may go forward against defendants Conklin, LaGuardia, McCullough, Puhar, Fiechter, Lewin & Associates, Somers and Altenbach, Robert Altenbach and TexOil; and

8. Plaintiffs' claims of conspiracy to violate Section 10(b) are DISMISSED with prejudice against defendants Schumacher & Hickey, Frederick Schumacher, Ltd., Houston Harbaugh, Peat, Marwick, the CLD Group, Doscher, The Doscher Group, Inc., Case Engineering, Taylor, and Friedman & Shaftan. Plaintiffs' conspiracy claims are DISMISSED without prejudice against defendants Baskin & Sears, Lewin & Associates, Lewin Energy, DiCicco, Kuuskraa, Technology Catalysts, Fox & Co., TexOil, Robert Altenbach and Somers and Altenbach. Plaintiffs' conspiracy claims may go forward against defendants Heim, Hilpert, Savery, Conklin, Basile, Coppage, Rogen, Bogdan, Cunningham, LaGuardia, McCullough, Pyles, Puhar, Fiechter, Krause, the Manhattan, Denver and Wichita partnerships, and the Petrotec Entities.

9. Plaintiffs' claims under Section 20(a) of the 1934 Act are DISMISSED against defendants Krause, Taylor, Rogen, Hilpert, Conklin, Pyles, and the Petrotec Entities; the claims against Heim, Savery, Basile, Coppage, Cunningham, Bogdan, McCullough, and LaGuardia may go forward; and

10. The ruling on claims under Section 15 of the 1933 Act is the same as the ruling on the Section 20 claims except that the claim against defendant Basile is also DISMISSED; and

11. All pendent state claims are DISMISSED against defendants Taylor, the CLD Group, the Doscher Group, Todd Doscher, Case Engineering, Schumacher and Hickey, Frederick Schumacher, Ltd., Houston Harbaugh, Friedman and Shaftan, and Peat, Marwick; and

12. The professional malpractice claim against Lewin & Associates is DISMISSED; and

13. The claims against defendant Pyles under Sections 25504 and 25504.1 of the California Corporations Code are DISMISSED; and

14. The claim against defendant Rogen under Section 25502 of the California Corporations Code is DISMISSED; and

15. The claim against Baskin and Sears under Section 25506.1 of the California Corporations Code is DISMISSED; and

16. The claim against defendant Pyles for negligent misrepresentation is DISMISSED; and

17. Defendants' motions to dismiss the common law conspiracy claims and fraud and deceit claims are DENIED; plaintiffs may go forward with the common law conspiracy claims against the defendants whom they've stated cognizable conspiracy claims under Section 10(b); and

18. Plaintiffs' motion for class certification pursuant to Fed.R.Civ.P. 23(a) and 23(b)(3) is GRANTED, as described above; and

19. Defendant Peat Marwick's motion and plaintiffs' cross-motion for Rule 11 sanctions are DENIED.

IT IS SO ORDERED.

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UNITED STATES DISTRICT COURT

NORTHERN DISTRICT OF CALIFORNIA

No. C-84-8069 TEH

FOURTH AMENDED CLASS ACTION COMPLAINT FOR VIOLATION OF FEDERAL SECURITIES LAWS AND STATE LAWS; FOR VIOLATION OF THE RACKETEER INFLUENCED AND CORRUPT ORGANIZATIONS ACT; AND FOR IMPOSITION OF A CONSTRUCTIVE TRUST

JURY TRIAL DEMANDED

PHILIP D. ROBERTS, LYNN ROBERTS, DENNY DELK, KAREN DELK, JACK T. BELL, and ARTHUR B. GAUSS, on behalf of themselves and all others similarly situated,

Plaintiffs,

v.

WERNER HEIM; WINSOR T. SAVERY; PETROTEC SYSTEMS, A.G. aka PETROTEC, A.G.; PETROTEC SYSTEMS, INC.;

PETROGENETIC SYSTEMS, A.G. aka PETROGENETICS, A.G.; PETROTEC HOLDINGS, A.G., fka PTI PETROTEC HOLDING, A.G.; PETROTEC MARKETING CORPORATION; PETROTEC DEVELOPMENT AND PRODUCTION, LTD.; PETROTEC LUGANO, A.G.; PAX-INNOVATIONS FOUNDATION aka THE PAXX FOUNDATION; COLUMBUS VALLEY, N.V.; MARDYN, N.V.; NELANTEX; NAROD, N.V.; TULSEBOND, LTD.; SHALELECTRIC, S.A.; FINAGEST, A.G. aka FINAGEST, LTD.; TAMARO HOLDING, INC.; MAX W. HILPERT; ELEKTRA ENERGY CORPORATION; ELEKTRA ENERGIE, A.V.; ELEKTRA OIL CORPORATION; HEMISPHERE LICENSING CORPORATION; RICHARD B. BASILE; GLENDA EXPLORATION AND DEVELOPMENT CORPORATION; LOUIS F. COPPAGE; AMERICAN ENERGY RESOURCES, INC.; AER INVESTMENTS, INC.; THE FORESEE GROUP, LTD.; GARY E. KRAUSE; C. NORRIS TAYLOR, JR.; ENERGY ASSOCIATES, INC.; TEXOIL INTERNATIONAL CORPORATION; NEIL E. ROGEN; PETROLEUM SCIENCES, INC.; LEWIN ENERGY CORPORATION; LEWIN AND ASSOCIATES, INC.; VELLO A. KUUSKRAA; TECHNOLOGY CATALYSTS, INC.; R.L. DICICCO; ERICH M. PUHAR; ARMIN FIECHTER; TODD MICHAEL DOSCHER; CLD GROUP, INC.; THE DOSCHER GROUP, INC.; CASE ENGINEERING AND LABORATORY, INC.; T. KENNETH PYLES; JAMES A. CUNNINGHAM; GREG E. BOGDAN; DARREL D. MCCULLOUGH; ROBERT LAGUARDIA; WILLIAM R. CONKLIN; BASKIN & STEINGUT, P.C. fka BASKIN & SEARS; FRIEDMAN & SHAFTAN, P.C.; SCHUMACHER & HICKEY; FREDERICK R. SCHUMACHER, LTD., A PROFESSIONAL LAW CORPORATION; FOX & COMPANY fka ELMER FOX WESTHEIMER & COMPANY; HOUSTON HARBAUGH fka HOUSTON, COHEN, HARBAUGH & LIPPARD; MAGNUM OIL AND GAS ASSOCIATES, 1979; MAGNUM OIL AND GAS ASSOCIATES, 1980; MAGNUM OIL AND GAS ASSOCIATES, 1980-II, TECHNOLOGY OIL AND GAS ASSOCIATES, 1979; TECHNOLOGY OIL AND GAS ASSOCIATES, 1980; TECHNOLOGY OIL AND GAS ASSOCIATES, 1980-II; WHITE RIM OIL AND GAS ASSOCIATES, 1979; WHITE RIM OIL AND GAS ASSOCIATES, 1980; WHITE RIM OIL AND GAS ASSOCIATES, 1980-II; WHITE

Rim Oil and Gas Associates, 1980-III; White Rim Oil and Gas Associates, 1980-IV; Garfield Oil and Gas Associates, 1979; Remington Oil and Gas Associates, 1979; Remington Oil and Gas Associates, 1980; Cromwell Oil and Gas Associates, 1979; Monroe Oil and Gas Associates, 1979; Winfield Oil and Gas Associates, 1979; Winchester Oil and Gas Associates, 1980; Boulder Oil and Gas Associates, 1980; Canyon Oil and Gas Associates, 1980; Durango Oil and Gas Associates, 1980; Powell Oil and Gas Associates, 1980; Harrow Oil Technology Partners—1981; Harrow Oil Technology Partners—1982; Cardinal Oil Technology Partners—1981; Caxton Oil Technology Partners—1981; Caxton Oil Technology Partners—1982; Caxton Oil Technology Partners—1983; Bishop Oil Technology Partners—1982; Bishop Energy Technology Associates—1982; Barton Enhanced Oil Production Income Fund—1982 fka Barton Energy Technology Associates—1982; Drake Oil Technology Partners, 1981; Vulcan Oil Technology Partners, 1981; Vanguard Oil Technology Partners, 1981; Derringer Oil Technology Partners, 1981; Derringer Oil Technology Partners, 1982; Crowne Oil Technology Partners, 1981; Dillon Oil Technology Partners, 1982; Carlton Oil Technology Partners, Ltd., 1983; Peat, Marwick, Mitchell & Co., Somers & Altenbach; and Robert E. Altenbach,

Defendants.

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* Page references refer to the pages in the Appendix.

Plaintiffs, by their attorneys, complain against defendants and make the following allegations, all of which are on information and belief, with the exception of the allegations of paragraphs 6-9 concerning the named plaintiffs.

JURISDICTION AND VENUE

1. This action arises under Sections 12, 15 and 17 of the Securities Act of 1933 (the "Securities Act") (15 U.S.C. §§ 77l, 77o and 77q), Section 10(b) of the Securities Exchange Act of 1934 (the "Exchange Act") (15 U.S.C. § 78j(b)), Rule 10b-5 promulgated thereunder (17 C.F.R. § 240.10b-5), Section 20(a) of the Exchange Act (15 U.S.C. § 78t(a)), Section 1965 of the Racketeer Influenced and Corrupt Organization Act (18 U.S.C. § 1965) and applicable state law.

2. This court has jurisdiction of this action under Section 22 of the Securities Act (15 U.S.C. § 77v), Section 27 of the Exchange Act (15 U.S.C. § 78aa), the provisions of the federal securities laws identified in the foregoing paragraph, and the principles of pendent jurisdiction.

3. Many of the acts charged herein, including the sale of unregistered securities and the dissemination of confidential memoranda, financial statements and tax returns containing omissions and misrepresentations of material fact, occurred in the Northern District of California. In addition, and as alleged more fully herein, the defendants either inhabit, transact business or reside in this district.

4. In connection with the acts alleged in this complaint, the defendants, directly or indirectly, used the means and instrumentalities of interstate commerce and of the mails.

5. Each of the defendants hereinafter named participated in, agreed to, adopted, ratified, and otherwise perpetrated a plan, concerted scheme, conspiracy and common course of conduct directed against plaintiffs and the members of the plaintiff class, as hereinafter defined, the details of which are more fully set forth in the Second Claim herein. The purpose and effect of

said plan, concerted scheme, conspiracy and common course of conduct was: (a) to induce plaintiffs and the members of the plaintiff class, as hereinafter defined, to purchase unregistered securities in various affiliated limited partnerships, hereinafter collectively referred to as the "Oil Technology Group Partnerships" or the "partnerships," which securities were required to be registered under the Securities Act of 1933, in order to enrich themselves at the expense of plaintiffs and the members of the plaintiff class, as hereinafter defined; and (b) to induce plaintiffs and the members of the plaintiff class, as hereinafter defined, to purchase said unregistered securities in said partnerships pursuant to documents containing omissions and misrepresentations of material fact. As hereinafter alleged, said plan, concerted scheme, conspiracy and common course of conduct commenced sometime in 1979 and continues to the present. All of the securities offered and sold to plaintiffs and the members of the plaintiff class, as hereinafter defined, were sold by the same issuer, and each defendant performed services for, or contracted with and participated in, agreed to, adopted and ratified the plan, concerted scheme, conspiracy and common course of conduct with said issuer.

PLAINTIFFS

6. Plaintiffs Philip D. Roberts and Lynn Roberts, husband and wife (hereinafter "Roberts"), purchasers of one (1) unit in Drake Oil Technology Partners, 1981 ("Drake"), made their initial investment on December 8, 1981. The purchase price of one (1) unit was $150,000, payment of which was effected by executing a check on the above indicated date in the amount of $12,500 payable to Drake, by simultaneously therewith executing, and thereafter paying, two (2) promissory notes in the amount of $12,500, which payments were made to Drake on or about April 15, 1982 and April 13, 1983, respectively, and by agreeing to long-term obligations payable to Drake in the total sum of $112,500.

(a) In connection with the prior to their initial cash payment on December 8, 1981, plaintiffs Roberts received, read and

were advised of the contents of the confidential memorandum for Drake dated August 10, 1981. After reading, reviewing and considering the contents of said confidential memorandum, and in reliance on the materials and representations contained therein, including, but not limited to, the tax opinion of defendant Somers & Altenbach, the geologic and financial analysis reports of defendant Lewin Energy Corporation, the opinion of defendant Technology Catalysts, Inc. on the portfolio of technologies that defendant Hemisphere Licensing Corporation purportedly made available to Drake, and the title opinion of defendant Houston, Cohen, Harbaugh & Lippard, plaintiffs Roberts decided to invest in Drake. In addition, plaintiffs Roberts decided to make their initial investment in Drake based on the fact that the confidential memorandum included the statement that defendant Peat, Marwick, Mitchell & Co. ("Peat") had agreed to provide accounting services to Drake. The issuer of said securities was the Oil Technology Group Partnerships, including the individual general partners thereof, and the Petrotec Entities which, as more fully alleged hereinafter, collectively constituted a single, integrated entity. Said integrated entity was a substantial factor and participant in the offer and sale of each and every interest in the partnerships, including those in Drake.

(b) In addition to receiving and reading various correspondence from the Petrotec Entities and Drake, plaintiffs Roberts received and read the Form K-1 partner's share of income, credits, deductions, etc. tax return for 1981 prepared by Peat subsequent to their initial payment but prior to making an additional capital contribution in the form of the payment on the promissory note due April 15, 1982, which payment constituted a separate purchase of securities;

(c) In addition to receiving and reading various correspondence from the Petrotec Entities and Drake, plaintiffs Roberts received and read the financial statement as of December 31, 1981 for Drake audited and opined on by Peat, subsequent to their initial payment and note payment in 1982, but prior to making the additional capital contribution in the form of the payment on the promissory note due April 15, 1983, which pay-

ment constituted a separate purchase of securities. It is plaintiffs Roberts' best belief that they also received and read the Form K-1 partner's share of income, credits, deductions, etc., tax return for 1982 prepared by Peat prior to making their April 15, 1983 note payment.

7. Plaintiff Arthur B. Gauss (hereinafter "Gauss"), a purchaser of one (1) unit in Dillon Oil Technology Partners, 1982 ("Dillon"), made his initial investment on December 28, 1982. The purchase price of one (1) unit was $150,000, payment of which was effected by executing a check on the above indicated date in the amount of $12,500 payable to American Energy Resources, Inc., by simultaneously therewith executing, and thereafter paying, two (2) promissory notes in the amount of $12,500, which payments were made to Dillon on or about February 20, 1983 and February 14, 1984, respectively, and by agreeing to long-term obligations payable to Dillon in the total sum of $112,500.

(a) In connection with and prior to his initial cash payment on December 28, 1982 plaintiff Gauss received, read and was advised of the contents of the confidential memorandum for Dillon dated February 15, 1982. After reading, reviewing and considering the contents of said confidential memorandum, and in reliance on the materials and representations contained therein, including, but not limited to, the tax opinion of defendant Somers & Altenbach, the geologic report of defendant Lewin Energy Corporation, the opinion of defendant Technology Catalysts, Inc. on the portfolio of technologies that defendant Hemisphere Licensing Corporation purportedly made available to Dillon, and the title opinion of defendant Houston, Cohen, Harbaugh and Lippard, plaintiff Gauss decided to invest in Dillon. In addition, plaintiff Gauss decided to make his initial investment in Dillon based on the fact that the confidential memorandum for Dillon included the statement that defendant Peat had agreed to provide accounting services to Dillon. The issuer of said securities was the Oil Technology Group Partnerships, including the individual and corporate general partners thereof, and the Petrotec Entities which, as more fully alleged hereinafter, collectively constituted a single,

integrated entity. Said integrated entity was a substantial factor and participant in the offer and sale of each and every interest in the partnerships, including those in Dillon.

(b) In addition to receiving and reading various correspondence from the Petrotec Entities and Dillon, plaintiff Gauss received and read the following documents concerning Dillon subsequent to his initial payment but prior to making the additional capital contribution in the form of a payment on the promissory note due February 15, 1984, which payment constituted a separate purchase of securities:

(i) The financial statements as of December 31, 1982 for Dillon audited and opined on by Peat;

(ii) The Form K-1 partner's share of income, credits, deductions, etc. tax return for 1982 prepared by Peat.

(8) Plaintiffs Denny and Karen Delk, husband and wife (hereinafter "Delk"), purchasers of one (1) unit in Vanguard Oil Technology Partners, 1981 ("Vanguard"), made their initial investment on December 28, 1981. The purchase price of one (1) unit was $150,000, payment of which was effected by executing a check on the above indicated date in the amount of $12,500 payable to Vanguard, by simultaneously therewith executing, and thereafter paying, two (2) promissory notes in the amount of $12,500, which payments were made to Vanguard on or before April 15, 1982 and April 15, 1983, respectively, and by agreeing to long-term obligations payable to Vanguard in the total sum of $112,500.

(a) In connection with and prior to their initial cash payment, on December 28, 1981 plaintiffs Delk received, read and were advised of the contents of the confidential memorandum for Vanguard dated September 11, 1981. After reading, reviewing and considering the contents of said confidential memorandum, and in reliance on the materials and representations contained therein, including, but not limited to, the tax opinion of defendant Somers & Altenbach, the geologic and financial analysis reports of defendant Lewin Energy Corporation, the opinion of defendant Technology Catalysts, Inc. on the port-

folio of technologies that defendant Hemisphere Licensing Corporation purportedly made available to Vanguard, and the title opinion of defendant Houston, Cohen, Harbaugh & Lippard, plaintiffs Delk decided to invest in Vanguard. In addition, plaintiffs Delk decided to make their initial investment in Vanguard based on the fact that the confidential memorandum for Vanguard inciuded the statement that defendant Peat had agreed to provide accounting services to Vanguard. The issuer of said securities was the Oil Technology Group Partnerships, including the individual and corporate general partners thereof, and the Petrotec Entities which, as more fully alleged hereinafter, collectively constituted a single, integrated entity. Said integrated entity was a substantial factor and participant in the offer and sale of each and every interest in the partnerships, including those in Vangaurd.

(b) In addition to receiving and reading various correspondence from the Petrotec Entities and Vanguard, plaintiffs Delk received and read the Form K-1 partner's share of income, credits, deductions, etc. tax return for 1981 prepared by Peat subsequent to their initial payment but prior to making an additional capital contribution in the form of a payment on the promissory note due April 15, 1982, which payment constituted a separate purchase of securities.

(c) In addition to receiving and reading various correspondence from the Petrotec Entities and Vanguard, plaintiffs Delk received and read the financial statement as of December 31, 1981 for Vanguard audited and opined on by Peat subsequent to their initial payment and note payment in 1982, but prior to making the additional capital contribution in the form of the payment on the promissory note due April 15, 1983, which payment constituted a separate purchase of securities. It is plaintiffs Delks' best belief that they also received and read the Form K-1 partner's share of income, credits, deductions, etc., tax return for 1982 prepared by Peat prior to making their April 15, 1983 note payment.

9. Plaintiff Jack T. Bell (hereinafter "Bell"), a purchaser of one (1) unit in Boulder Oil and Gas Associates, 1980 ("Boul-

der"), made his initial investment on December 6, 1980. The purchase price of one (1) unit was $230,000, payment of which was effected by executing a check on the above indicated date in the amount of $10,000 payable to Boulder, by simultaneously therewith executing, and thereafter paying, two (2) promissory notes in the amount of $10,000, which payments were made to Boulder on or before March 1, 1981 and February 26, 1982, respectively, and by agreeing to long-term obligations payable to Boulder 1980 in the total sum of $200,000.

(a) In connection with and prior to his initial cash payment on December 6, 1980, plaintiff Bell received, read and was advised of the contents of the confidential memorandum for Boulder dated July 25, 1980. After reading, reviewing and considering the contents of said confidential memorandum, and in reliance on the materials and representations contained therein, including, but not limited to, the tax opinion of defendant Baskin & Sears, the letter of defendant Friedman & Shaftan, P.C. re tax assistance, the estimated federal tax savings and cash flow projection of defendant Fox & Company, and the report on the Utah Tar Sand Triangle, Utah, Circle Cliffs, Utah and Burnt Hollow, Wyoming prepared by defendant Lewin Energy Corporation, plaintiff Bell decided to invest in Boulder. The issuer of said securities was the Oil Technology Group Partnerships, including the individual and corporate general partners thereof, and the Petrotec Entities which, as more fully alleged hereinafter, collectively constituted a single, integrated entity. Said integrated entity was a substantial factor and participant in the offer and sale of each and every interest in the partnerships, including those in Boulder.

10. A market for the interests in the Oil Technology Group Partnerships was created by the defendants and others, including broker dealers and financial planners specializing in tax-oriented investments during the period 1979-1984. The market for the Oil Technology Group Partnership interests was part of a larger tax-oriented investment market which existed during the aforementioned period, and pursuant to which substantial sums of investor capital were raised. While such market did not involve a pricing mechanism of the type associated with the

national securities exchanges, it nonetheless existed such that tax-oriented investments, such as the Oil Technology Group Partnerships, were priced and offered as genuine investments by and through an established financial medium, including broker dealers, investment advisors and financial planners. In making their decisions to invest, plaintiffs relied on the availability of the Oil Technology Group Partnership interests on the market for tax-oriented investments, as hereinabove described, as well as the regulatory process through which the securities were offered, as evidence of their genuineness and marketability. As hereinafter alleged, had the true facts been known, the securities plaintiffs purchased would have been worthless and unmarketable at any price and would never have been issued or marketed absent the fraudulent scheme hereinafter described.

DEFENDANTS

11. *The Petrotec Entities.* The following corporations and entities, hereinafter collectively referred to as the "Petrotec Entities," were owned, controlled and/or managed by each other and by the individual defendants hereinafter identified. The Petrotec Entities, through their agents, controlled the Oil Technology Group Partnerships identified in paragraph 11 hereof, and, as hereinafter more fully alleged, were responsible, collectively, for the formulation of the plan, concerted scheme, conspiracy and common course of conduct herein alleged.

(a) Petrotec Systems, A.G. ("Petrotec"), also known as Petrotec, A.G., is a corporation formed under the laws of Switzerland. At times relevant herein, Petrotec was owned by Werner Heim ("Heim") and Max. W. Hilpert ("Hilpert") and was the parent of, and/or controlled, defendants Elektra Energie, A.V., Elektra Oil Corporation, Elektra Energy Corporation, and Hemisphere Licensing Corporation. Petrotec purportedly located certain enhanced oil recovery ("EOR") technologies for licensing to Elektra Oil Corporation, Elektra Energy Corporation and Hemisphere Licensing Corporation.

Petrotec was a promoter with respect to the Oil Technology Group Partnerships.

(b) Petrogenetic Systems, A.G. ("Petrogenetic"), also known as Petrogenetics, A.G., is a corporation formed under the laws of Switzerland. At times relevant herein, Petrogenetic was owned by Heim and Hilpert. Petrogenetic purportedly conducted research into microbial EOR technologies, and licensed such technologies to Hemisphere Licensing Corporation.

(c) Petrotec Holdings, A.G., formerly known as PTI Petrotec Holding, A.G., is a corporation formed under the laws of Switzerland. At times relevant herein, PTI Petrotec was owned by Heim and Hilpert. PTI Petrotec is the parent of Petrotec and Petrogenetic.

(d) Petrotec Marketing Corporation is a corporation formed by defendant Louis F. Coppage purportedly to market sublicenses for certain EOR technologies obtained by the Oil Technology Group Partnerships from Hemisphere Licensing Corporation.

(e) Petrotec Development and Production, Ltd. is a corporation with its principal place of business in Wichita, Kansas which participated in the acts, practices, conspiracy and common course of conduct hereinafter alleged.

(f) Petrotec Systems, Inc. is a Nevada corporation with its principal place of business in The Woodlands, Texas. Petrotec Systems is a subsidiary of Petrotec Systems, A.G., and is the alter ego of Hemisphere Licensing Corporation and participated in the acts, practices, conspiracy, common course of conduct and transactions hereinafter alleged.

(g) Petrotec Lugano, A.G. is a corporation formed by Heim under the laws of Switzerland which participated in the acts, practices, conspiracy, common course of conduct and transactions hereinafter alleged. Substantial sums of investor money have been, and continue to be, diverted to Petrotec Lugano.

(h) The PAX-Innovations Foundation, also known as The Paxx Foundation, is a trust formed by Heim under the laws of

Lichtenstein. Substantial sums of investor money have been, and continue to be, diverted to said trust.

(i) Columbus Valley, N.V. is a corporation formed by Heim under the laws of the Netherlands Antilles which, at relevant times herein, was one of the parent corporations of Hemisphere Licensing Corporation. Substantial sums of investor money have been, and continue to be, diverted to Columbus Valley.

(j) Mardyn, N.V. is a corporation formed by Heim under the laws of the Netherlands Antilles which, at relevant times herein, was one of the parent corporations of Elektra Oil Corporation and Elektra Energy Corporation. Substantial sums of investor money have been, and continue to be, diverted to Mardyn, N.V.

(k) Nelantex is a Dutch corporation formed and controlled by Heim which, at relevant times herein, was the parent corporation of Mardyn, N.V. Substantial sums of investor money have been, and continue to be, diverted to Nelantex.

(l) Narod, N.V. is a corporation formed by Heim under the laws of the Netherlands Antilles which, at relevant times herein, was the parent corporation of Nelantex. Substantial sums of investor money have been, and continue to be, diverted to Narod, N.V.

(m) Tulsebond, Ltd. is a British corporation formed and controlled by Heim. By virtue of assignments from certain of the other Petrotec Entities, as detailed hereinbelow, Tulsebond acquired working interests in properties that were purportedly oil-bearing and thereafter leased said properties to various of the Oil Technology Group Partnerships at grossly inflated costs.

(n) Shalelectric, S.A. is a corporation formed by Heim under the laws of Panama which participated in the acts, practices, conspiracy, common course of conduct and transactions hereinafter alleged. Substantial sums of investor money have been, and continue to be, diverted to Shalelectric.

(o) Finagest, A.G., also known as Finagest, Ltd., is a corporation formed by Heim under the laws of Switzerland which participated in the acts, practices, conspiracy, common course of conduct and transactions hereinafter alleged. Finagest was the corporate vehicle by which defendant Heim initially acquired interests in properties that were purportedly oil-bearing and subsequently leased them to various of the Oil Technology Group Partnerships at grossly inflated costs.

(p) Tamaro Holding, Inc. is a corporation formed by Heim under the laws of Panama which participated in the acts, practices, conspiracy, common course of conduct and transactions hereinafter alleged. By virtue of an assignment from defendant Finagest, Tamaro Holding acquired interests in properties that were purportedly oil-bearing and thereafter assigned its interests in said properties to defendant Tulsebond, which in turn leased the properties to the partnerships at grossly inflated costs.

(q) Elektra Energy Corporation ("Elektra Energy"), a corporation formed by Heim and defendant Winsor T. Savery ("Savery") under the laws of Delaware and a subsidiary of Petrotec Systems, A.G., purportedly licensed EOR technologies to the Oil Technology Group Partnerships syndicated in 1980, as hereinafter specified. Elektra Energy was a promoter with respect to certain of the Oil Technology Group Partnerships.

(r) Elektra Oil Corporation ("Elektra Oil"), the predecessor of Elektra Energy, is a corporation formed under the laws of Delaware, and is a subsidiary of defendant Mardyn, N.V. Elektra Oil purportedly licensed EOR technologies to the Oil Technology Group Partnerships syndicated in 1979, as hereinafter specified. Elektra Oil was a promoter with respect to certain of the Oil Technology Group Partnerships.

(s) Elektra Energie, A.V., a corporation formed by Heim under the laws of Switzerland, at times relevant herein, was the parent corporation of Elektra Energy and Elektra Oil. Substantial sums of investor money have been, and continue to be, diverted to Elektra Energie, A.V.

(t) Hemisphere Licensing Corporation ("Hemisphere") is a Texas corporation with its principal place of business in The Woodlands, Texas. Hemisphere purportedly licensed EOR technologies to the Oil Technology Group Partnerships syndicated in 1981-1983, as hereinafter specified. At various times relevant herein, defendants Heim, Hilpert, Neil E. Rogen ("Rogen"), and William R. Conklin ("Conklin") served as president and/or chairman of the board of directors of Hemisphere. Hemisphere was a promoter with respect to certain of the Oil Technology Group Partnerships.

(u) Petroleum Sciences, Inc. ("PSI"), a corporation formed under the laws of Delaware, is a wholly-owned subsidiary of Hemisphere which, as of March 1, 1984, had its license to do business suspended for failure to pay taxes. PSI purportedly was an EOR technology consulting firm retained by the Oil Technology Group Partnerships syndicated in 1981-1983. At times relevant herein, defendant Rogen served as president of PSI.

(v) American Energy Resources, Inc. ("AER") is a corporation formed under the laws of Colorado with its principal place of business in Ogden, Utah. AER is the corporate general partner of various of the Oil Technology Group Partnerships syndicated in 1981-1983, as hereinafter specified. At all times relevant herein, defendant Louis F. Coppage ("Coppage") was the principal shareholder in AER. AER was a promoter with respect to certain of the Oil Technology Group Partnerships.

(w) AER Investments, Inc., a corporation formed under the laws of Colorado with its principal place of business in Ogden, Utah, is a SECO broker-dealer that acted as the Managing Dealer for the offering of interests in various of the Oil Technology Group Partnerships. Defendant Louis F. Coppage is a founder, principal stockholder and chairman of the board of directors of AER Investments, Inc.

(x) The Foresee Group, Ltd., a corporation formed under the laws of Colorado with its principal place of business in Ogden, Utah, is wholly-owned by defendant Coppage and is engaged in the business of financial planning and marketing of

tax-oriented limited partnerships. The Foresee Group participated in the acts, practices, conspiracy, common course of conduct and transactions hereinafter alleged.

(y) Energy Associates, Inc. is a corporation formed under the laws of Kansas with its principal place of business in Wichita, Kansas. Energy Associates is the corporate general partner of various of the Oil Technology Group Partnerships, syndicated in 1981-1983, as hereinafter specified. At all times relevant herein, defendant Gary E. Krause ("Krause") was the principal shareholder in Energy Associates. Energy Associates was a promoter with respect to certain of the Oil Technology Group Partnerships.

(z) Glenda Exploration and Development Corporation ("GEDCO") is a Texas corporation with its principal place of business in New York, New York. GEDCO, which is wholly-owned by defendant Richard B. Basile, is a corporate general partner of the Oil Technology Group Partnerships syndicated in 1979-1980, as hereinafter specified. GEDCO was a promoter with respect to certain of the Oil Technology Group Partnerships.

12. *The Oil Technology Group Partnerships.* The following limited partnerships were controlled and managed by the Petrotec Entities and their agents, as hereinafter specifed. Interests in these partnerships were initially offered and sold to investors pursuant to confidential memoranda.

(a) *The Manhattan Partnerships.* In 1979 and 1980, Werner Heim, Winsor T. Savery and Richard B. Basile formed and marketed interests in the partnerships hereinafter identified (the "Manhattan Partnerships"). Each of these limited partnerships is purportedly engaged in the business of drilling for, producing and marketing gas located in the Monroe Field, Louisiana and producing heavy oil on certain properties that purportedly bear heavy oil in Wyoming and Utah. Each of the Manhattan Partnerships has the same corporate and individual general partners, defendants GEDCO and Basile, respectively. Basile purchased GEDCO sometime in 1983. The Manhattan Partner-

ships, which are purportedly headquartered in GEDCO's and Basile's New York City office, are:

Magnum Oil and Gas Associates, 1979
Technology Oil and Gas Associates, 1979
White Rim Oil and Gas Associates, 1979
Garfield Oil and Gas Associates, 1979
Magnum Oil and Gas Associates, 1980
Magnum Oil and Gas Associates, 1980-II
Technology Oil and Gas Associates, 1980
Technology Oil and Gas Associates, 1980-II
White Rim Oil and Gas Associates, 1980
White Rim Oil and Gas Associates, 1980-II
White Rim Oil and Gas Associates, 1980-III
White Rim Oil and Gas Associates, 1980-IV
Winchester Oil and Gas Associates, 1980
Boulder Oil and Gas Associates, 1980
Canyon Oil and Gas Associates, 1980
Durango Oil and Gas Associates, 1980
Powell Oil and Gas Associates, 1980
Remington Oil and Gas Associates, 1980

(b) *The Denver Partnerships.* In 1979 and 1981-1983, Werner Heim, Winsor T. Savery and Louis F. Coppage formed and marketed interests in the partnerships hereinafter identified (the "Denver Partnerships"). The Denver Partnerships syndicated in 1979 are purportedly engaged in the business of drilling for, producing and marketing gas located in the Monroe Field, Louisiana and producing heavy oil on certain properties that purportedly bear heavy oil in Wyoming and Utah. The Denver Partnerships syndicated in 1981-1983 are purportedly engaged in the business of acquiring producing oil wells and their adjoining properties and improving production therefrom by applying EOR technologies. All of the Denver Partnerships had the same individual general partner, defendant Louis F. Coppage. Many of the Denver Partnerships have the same corporate general partner. GEDCO serves as the corporate general partner for the Denver Partnerships syndicated in 1979. AER serves as the corporate general partner for the Denver Partner-

ships syndicated in 1981-1983. The Denver Partnerships, which are purportedly headquartered in Coppage's Ogden, Utah office, are:

Monroe Oil and Gas Associates, 1979
Cromwell Oil and Gas Associates, 1979
Remington Oil and Gas Associates, 1979
Winfield Oil and Gas Associates, 1979
Drake Oil Technology Partners, 1981
Vulcan Oil Technology Partners, 1981
Vanguard Oil Technology Partners, 1981
Crowne Oil Technology Partners, 1981
Derringer Oil Technology Partners, 1981
Derringer Oil Technology Partners, 1982
Dillon Oil Technology Partners, 1982
Carlton Oil Technology Partners, Ltd., 1983

(c) *The Wichita Partnerships.* In 1981-1982, Werner Heim, Winsor T. Savery and Gary E. Krause formed and marketed interests in the partnerships hereinafter identified (the "Wichita Partnerships"). Each of these limited partnerships is purportedly engaged in the business of acquiring producing oil wells and their adjoining properties and improving production therefrom by applying EOR technologies. Each of the Wichita Partnerships has the same corporate and individual general partners, which are defendants Energy Associates, Inc. and Krause, respectively. The Wichita Partnerships, which are purportedly headquartered in Energy Associates, Inc.'s and Krause's Wichita office, are:

Harrow Oil Technology Partners—1981
Harrow Oil Technology Partners—1982
Cardinal Oil Technology Partners—1981
Caxton Oil Technology Partners—1981
Caxton Oil Technology Partners—1982
Caxton Oil Technology Partners—1983
Bishop Energy Technology Associates—1982
Bishop Oil Technology Partners—1982
Barton Enhanced Oil Production Income Fund—1982

13. *The Individual Defendants.* At times relevant herein, the individual defendants identified below acted as officers and/or directors of the Petrotec Entities:

(a) Werner Heim ("Heim") is a resident of Zurich, Switzerland. At all times relevant herein, Heim, in concert with others, controlled the Petrotec Entities, as hereinabove defined, and at various times relevant herein served as chairman of the board and president of Petrotec, Petrogenetic, PTI Petrotec, Elektra Oil, Elektra Energy and Hemisphere.

(b) Winsor T. Savery ("Savery") is a resident of The Woodlands, Texas. At all times relevant herein, Savery served as an officer and/or director of defendants Elektra Oil, Elektra Energy and Hemisphere. Savery is currently the president of Elektra Energy and Hemisphere.

(c) Max W. Hilpert ("Hilpert") is a resident of Zurich, Switzerland. At various times relevant herein, Hilpert served as chairman of the board of Petrotec, PTI Petrotec, Elektra Oil, Elektra Energy and Hemisphere.

(d) Richard B. Basile ("Basile") is a resident of New York and is the individual general partner for the Manhattan Partnerships, as hereinabove specified. In 1983 Basile became the president and sole stockholder of defendant GEDCO.

(e) Louis F. Coppage ("Coppage") is a resident of California and is the individual general partner for the Denver Partnerships, as hereinabove specified. Coppage also is the president of defendants AER, AER Investments, Inc., The Foresee Group, Ltd., and Petrotec Marketing Corporation.

(f) Gary E. Krause ("Krause") is a resident of Kansas and is the individual general partner for the Wichita Partnerships, as hereinabove specified. Krause is the president of defendant Energy Associates, Inc.

(g) Neil E. Rogen ("Rogen") is a resident of Connecticut who at times relevant herein served as president of Elektra Energy, Hemisphere, and PSI.

(h) T. Kenneth Pyles is a resident of Georgia who at times relevant herein served as president of AER.

(i) James A. Cunningham is a resident of Colorado who at times relevant herein served as president of AER and a member of the board of directors and principal stockholder of AER Investments.

(j) Greg E. Bogdan is a resident of California who at times relevant herein served as president of AER Investments and vice-president of finance of AER.

(k) Darrel D. McCullough is a resident of Colorado who at times relevant herein served as vice-president of marketing for AER.

(l) C. Norris Taylor, Jr. is a resident of Kansas who at times relevant herein served as vice-president, secretary and director of Energy Associates, Inc.

(m) Robert LaGuardia is a resident of Colorado who at times relevant herein served as controller and chief financial officer of AER.

(n) William R. Conklin is a resident of California who at times relevant herein served as an officer and/or director of Elektra Energy, Hemisphere, and PSI.

(o) Erich M. Puhar is a resident of Switzerland who at times relevant herein served as president of Petrogenetic, vice-president of Petrotec, and executive vice-president of PTI Petrotec.

(p) Armin Fiechter is a resident of Switzerland who at times relevant herein served as a member of the board of directors of Petrotec and PTI Petrotec and as a consultant for PSI.

14. *The Individual General Partners.* At times relevant herein, the following individual defendants served as individual general partners of the Oil Technology Group Partnerships:

Richard B. Basile
Louis F. Coppage
Gary E. Krause

Attached hereto as Exhibit A and incorporated herein by this reference is a listing of each partnership for which these individual defendants acted as general partners.

15. *The Attorney Defendants.* The following law firms provided tax and securities advice and opinions to the partnerships and, as hereinafter more fully alleged, agreed to and participated in the plan, concerted scheme, conspiracy and common course of conduct herein alleged.

(a) Baskin & Steingut, P.C., formerly known as Baskin & Sears, is a law firm with offices located in various cities throughout the United States. The firm provided tax advice and opinions to the Petrotec Entities and the Manhattan Partnerships syndicated in 1980. Based on the information currently available, plaintiffs are informed and believe and thereon allege that the firm's tax opinion appeared in the confidential memoranda for the following partnerships: Magnum Oil and Gas Associates, 1980; Magnum Oil and Gas Associates, 1980-II; Technology Oil and Gas Associates, 1980; Technology Oil and Gas Associates, 1980-II; White Rim Oil and Gas Associates, 1980; White Rim Oil and Gas Associates, 1980-II; Winchester Oil and Gas Associates, 1980; Boulder Oil and Gas Associates, 1980; Canyon Oil and Gas Associates, 1980; Durango Oil and Gas Associates, 1980; Powell Oil and Gas Associates, 1980; and Remington Oil & Gas Associates, 1980. Baskin and Sears also provided a tax assistance letter which appeared in certain of the confidential memoranda identified above.

(b) Friedman & Shaftan, P.C. is a law firm located at 4 Park Avenue, New York, New York. The firm provided tax advice and opinions to the Petrotec Entities and the Manhattan Partnerships syndicated in 1979. Based on the information currently available, plaintiffs are informed and believe and thereon alleged that the firm's tax opinion appeared in the confidential memoranda for the following partnerships: Magnum Oil and Gas Associates, 1979; Technology Oil and Gas Associates, 1979; White Rim Oil and Gas Associates, 1979; and Garfield Oil and Gas Associates, 1979. Friedman & Shaftan also provided a tax assistance letter which appeared in the confidential

memoranda identified above, as well as the confidential memoranda for, among others, Boulder Oil and Gas Associates, 1980.

(c) Somers & Altenbach is a law firm located at 400 Perimeter Center, Atlanta, Georgia. The firm provided tax advice and opinions to the Petrotec Entities and the Denver Partnerships syndicated in 1981-1983. The firm's tax opinion appeared in the confidential memoranda for the following partnerships: Drake Oil Technology Partners, 1981; Vulcan Oil Technology Partners, 1981; Vanguard Oil Technology Partners, 1981; Crowne Oil Technology Partners, 1981; Derringer Oil Technology Partners, 1981; Derringer Oil Technology Partners, 1982; Dillon Oil Technology Partners, 1982; and Carlton Oil Technology Partners, Ltd., 1983. Somers & Altenbach also provided a tax assistance letter which appeared in the confidential memoranda identified above.

(d) Robert E. Altenbach ("Altenbach") is an attorney with offices in Atlanta, Georgia. Altenbach was a member of Somers & Altenbach at all times relevant herein. Altenbach provided tax advice and opinions to the Petrotec Entities and to the Denver Partnerships identified in paragraph 16 hereinabove.

(e) Schumacher & Hickey was a law firm located in Newport Beach, California which provided tax advice and opinions to the Petrotec Entities and certain of the Wichita Partnerships. Based on the information currently available, plaintiffs are informed and believe and thereon alleged that the firm's tax opinion appeared in the confidential memoranda for the following partnerships: Harrow Oil Technology Partners—1981; Cardinal Oil Technology Partners—1981; and Caxton Oil Technology Partners—1981. Schumacher & Hickey also provided a tax assistance letter which appeared in the confidential memoranda identified above.

(f) Frederick R. Schumacher Ltd., A Professional Law Corporation is a law firm with offices at 4200 Campus Drive, Newport Beach, California. Based on the information currently available, plaintiffs are informed and believe and thereon alleged that the firm provided tax advice and opinions to the

Petrotec Entities and certain of the Wichita Partnerships. The firm's tax opinion appeared in the confidential memoranda for the following partnerships: Harrow Oil Technology Partners—1982 and Caxton Oil Technology Partners—1982. Frederick R. Schumacher Ltd. also provided a tax assistance letter which appeared in the confidential memoranda identified above.

16. Houston Harbaugh, formerly known as Houston, Cohen, Harbaugh & Lippard ("Houston Harbaugh"), is a law firm located at Two Chatham Center, Pittsburgh, Pennsylvania. The firm provided title opinions to the Petrotec Entities and to certain of the Denver and Wichita Partnerships. The firm's title opinions appeared in the confidential memoranda for the following partnerships: Drake Oil Technology Partners, 1981; Vulcan Oil Technology Partners, 1981; Vanguard Oil Technology Partners, 1981; Crowne Oil Technology Partners, 1981; Derringer Oil Technology Partners, 1981; Derringer Oil Technology Partners, 1982; Dillon Oil Technology Partners, 1982; Harrow Oil Technology Partners—1981; Harrow Oil Technology Partners—1982; Cardinal Oil Technology Partners—1981; Caxton Oil Technology Partners—1981; Caxton Oil Technology Partners—1982; Bishop Energy Technology Associates—1982 and Bishop Oil Technology Partners—1982.

17. *The Accounting Defendants.* The following accounting firms provided accounting services, including reports on financial statements, preparation of tax returns, tax opinions and projections to the partnerships and, as hereinafter more fully alleged, agreed to and participated in the plan, concerted scheme, conspiracy and common course of conduct herein alleged.

(a) Peat, Marwick, Mitchell & Co. ("Peat") is a public accounting firm which provided accounting services, including the preparation of tax returns and the rendering of audit reports on financial statements, to the Petrotec Entities and the Denver Partnerships syndicated in 1981-1983. In addition, the confidential memoranda for the following partnerships contained the representation that "Peat, Marwick, Mitchell & Co., Den-

ver, Colorado has agreed to perform accounting services for the Partnership, including the preparation of tax returns and audited financial statements'': Drake Oil Technology Partners, 1981; Vulcan Oil Technology Partners, 1981; Vanguard Oil Technology Partners, 1981; Crowne Oil Technology Partners, 1981; Derringer Oil Technology Partners, 1981; Derringer Oil Technology Partners, 1982; Dillon Oil Technology Partners, 1982; and Carlton Oil Technology Partners, Ltd., 1983. Pursuant thereto, Peat audited and opined on the financial statements of, and prepared the tax returns for said partnerships for the years ended December 31, 1981, December 31, 1982, December 31, 1983, December 31, 1984, which opinions were disseminated to investors in said partnerships. In addition, Peat audited and opined on the financial statement for AER Investments, Inc. as of the years ended May 31, 1981 and 1982, which audit opinion appeared in the confidential memorandum for Carlton Oil Technology Partners, Ltd.

(b) Fox & Company (''Fox''), formerly known as Elmer Fox, Westheimer & Company, is a public accounting firm which provided summary projections of estimated federal income tax savings and cash flow and tax opinions to the Petrotec Entities and the Manhattan Partnerships. Based on the information currently available, plaintiffs are informed and believe and thereon allege that Fox's summary projections of federal income tax savings and cash flow appeared in the confidential memoranda for the following partnerships: Magnum Oil and Gas Associates, 1979; Technology Oil and Gas Associates, 1979; White Rim Oil and Gas Associates, 1979; Garfield Oil and Gas Associates, 1979; Magnum Oil and Gas Associates, 1980; Technology Oil and Gas Associates, 1980; White Rim Oil and Gas Associates, 1980; Winchester Oil and Gas Associates, 1980; Boulder Oil and Gas Associates, 1980; Canyon Oil and Gas Associates, 1980; Durango Oil and Gas Associates, 1980; Powell Oil and Gas Associates, 1980; and Remington Oil and Gas Associates, 1980. Based on the information currently available, plaintiffs are informed and believe and thereon allege that Fox's tax opinion appeared in the confidential memoranda for the following partnerships: Technology Oil and Gas Associates,

1979 and White Rim Oil and Gas Associates, 1979. The confidential memoranda for the following partnerships contained the representation that "Fox & Co., Wichita, Kansas, has agreed to perform accounting services for the partnership, including the preparation of tax returns and audited financial statements": Harrow Oil Technology Partners—1981; Caxton Oil Technology Partners—1981; and Cardinal Oil Technology Partners—1981. Pursuant thereto, Fox audited and opined on the financial statements of, and prepared the tax returns for, said partnerships for the years ending December 31, 1981, December 31, 1982, December 31, 1983 and December 31, 1984, which opinions were disseminated to investors in said partnerships.

18. *The Consulting Defendants.* At times relevant herein the following corporations and individuals, hereinafter collectively referred to as the "Consulting Defendants," rendered consulting services and/or reports and opinions to the Petrotec Entities and the partnerships. As hereinafter more fully alleged, each consulting defendant agreed to and participated in the plan, concerted scheme, conspiracy and common course of conduct herein alleged.

(a) Lewin Energy Corporation ("Lewin Energy") is a Delaware corporation with its principal place of business in Washington, D.C. As more fully described below, Lewin rendered opinions to the Petrotec Entities and the partnerships respecting the amount of, and ability to profitably recover, oil in the Tar Sand Triangle and Circle Cliffs, Utah, Burnt Hollow, Wyoming and the Parker Field, Pennsylvania. These opinions appeared in each of the confidential memoranda for the Manhattan Partnerships syndicated in 1980, and the Denver and Wichita Partnershps syndicated in 1981-1983. Lewin also rendered opinions on the projected financial consequences of investing in certain of the partnerships. These opinions appeared in each of the confidential memoranda for the Denver and Wichita Partnerships syndicated in 1981.

(b) Vello A. Kuuskraa was at all times relevant herein the president and/or chairman of the board of Lewin and the vice-president and chief financial officer of defendant Lewin and

Associates, Inc. and signed the opinions referred to in paragraph 23(a) above. At various times relevant herein, Kuuskraa also served as chairman of the board of defendant CLD Group, Inc.

(c) Lewin and Associates, Inc. ("Lewin and Associates") is a Delaware corporation with its principal place of business in Washington, D.C. Lewin and Associates at all times relevant herein was the parent corporation of defendant Lewin Energy Corporation. As more fully described below, Lewin and Associates substantially assisted its wholly-owned subsidiary in the preparation of the opinions identified in paragraph 23(a) above, which opinions appeared in the confidential memoranda therein set forth. At relevant times herein, Lewin and Associates was also a major stockholder in defendant CLD Group, Inc.

(d) Technology Catalysts, Inc., is a Delaware corporation with its principal place of business in Falls Church, Virginia. Technology Catalysts rendered opinions to the Petrotec Entities and the Denver and Wichita Partnerships syndicated in 1981-1982 respecting the value and uniqueness of Hemisphere's portfolio of EOR technologies. Said opinions appeared in the confidential memoranda for the following partnerships: Drake Oil Technology Partners, 1981; Vulcan Oil Technology Partners, 1981; Vanguard Oil Technology Partners, 1981; Crowne Oil Technology Partners, 1981; Derringer Oil Technology Partners, 1982; Dillon Oil Technology Partners, 1982; Carlton Oil Technology Partners, Ltd., 1983; Harrow Oil Technology Partners—1981; Harrow Oil Technology Partners—1982; Cardinal Oil Technology Partners—1981; Caxton Oil Technology Partners—1981; and Caxton Oil Technology Partners—1982.

(e) R. L. DiCicco was at all times relevant herein the president of defendant Technology Catalysts and signed the opinions referred to in paragraph 23(d) above.

(f) Todd Michael Doscher is a petroleum engineer and a resident of Ventura, California. Doscher is the president of defendants CLD Group, Inc. and The Doscher Group, Inc. Doscher rendered consulting services and expertise to the partnerships

syndicated in 1980-1982 respecting EOR technologies and was prominently identified in the confidential memoranda for said partnerships as an expert on EOR.

(g) CLD Group, Inc. ("CLD") is a Delaware corporation with its principal place of business in Ventura, California. CLD provided opinions to the Petrotec Entities and the Manhattan and Denver Partnerships syndicated in 1979 identifying the acreage in the Tar Sand Triangle, Circle Cliffs, Utah, and Burnt Hollow, Wyoming, most amenable to heavy oil production. Based on the information currently available, plaintiffs are informed and believe and thereon allege that said opinions appeared in the confidential memoranda for the following partnerships: Magnum Oil and Gas Associates, 1979; Technology Oil and Gas Associates, 1979; White Rim Oil and Gas Associates, 1979; Garfield Oil and Gas Associates, 1979; Cromwell Oil and Gas Associates, 1979; Monroe Oil and Gas Associates, 1979; Remington Oil and Gas Associates, 1979; and Winfield Oil and Gas Associates, 1979. CLD also purportedly rendered consulting services and expertise in EOR technology to the partnerships syndicated in 1981-1982. The sole stockholders in CLD are defendants Lewin and Associates, Inc., The Doscher Group, Inc. and Case Engineering and Laboratory, Inc.

(h) The Doscher Group, Inc. is a Delaware corporation with its principal place of business in Los Angeles, California. The Doscher Group provided consulting services and expertise in the field of EOR technology to the partnerships identified in subparagraph (g) above. At relevant times herein, The Doscher Group, Inc. was also a major stockholder in defendant CLD Group, Inc.

(i) Case Engineering and Laboratory, Inc. ("Case") is a California corporation which had its license to do business suspended as of October 1, 1984. Case purportedly provided consulting services and expertise in the field of EOR technologies to various of the partnerships. At relevant times herein, Case was also a major stockholder in defendant CLD Group, Inc.

(j) TexOil International Corporation ("TexOil") is a Delaware corporation with its principal place of business in Houston, Texas. TexOil sold leases on properties purportedly bearing heavy oil to the Manhattan Partnerships, and the Denver Partnerships syndicated in 1979, in consideration of the payment by said partnerships of minimum annual royalties, as hereinafter more fully described.

PLAINTIFF CLASS ACTION ALLEGATIONS

19. This action is brought as a plaintiff class action pursuant to Rule 23(b)(3) of the Federal Rules of Civil Procedure.

20. Plaintiffs seek certification of a plaintiff class defined to include all persons and entities, other than defendants herein, who purchased interests in the Oil Technology Group Partnerships, as defined in paragraph 12 hereinabove. The plaintiffs are members of said class.

21. This action is maintained as a plaintiff class action because:

(a) The class has in excess of 1,000 members, thereby rendering joinder of all such class members impracticable;

(b) There are questions of law or fact common to the class;

(c) The claims of the named plaintiffs are typical of the claims of the class;

(d) The named plaintiffs will fairly and adequately protect the interests of the class;

(e) The named plaintiffs and the class are represented by able counsel experienced in class action securities litigation;

(f) The questions of law and fact common to the class predominate over any questions affecting only individual members;

(g) A class action is superior to other available methods for the fair and efficient adjudication of the controversy; and

(h) Plaintiffs know of no difficulty which will be encountered in the management of this litigation and which would preclude its maintenance as a plaintiff class action.

OFFERS AND SALES OF PARTNERSHIP INTERESTS

22. Beginning in 1979, Werner Heim, Max W. Hilpert, Winsor T. Savery and the Petrotec Entities they controlled, in concert with the other defendants, particularly Louis F. Coppage, Richard B. Basile and Gary E. Krause, launched and perpetrated a plan, concerted scheme, conspiracy and common course of conduct directed against the plaintiffs and the members of the class they seek to represent. The purpose and effect of said plan, concerted scheme, conspiracy and common course of conduct was to induce investors to purchase interests in limited partnerships ostensibly created to: (a) acquire, develop and operate existing oil and gas wells on proven oil and gas properties; and (b) to apply enhanced oil recovery technologies on oil-bearing properties to increase production therefrom. During the period 1979, continuing through and to the present, Heim, Hilpert, Savery and the Petrotec Entities over which they exercised control, and in concert and conspiracy with the other defendants, including, but not limited to Coppage, Basile and Krause, in a single, continuous offering of securities, sold limited partnership interests to thousands of investors and raised at least $200 million in cash.

23. Each of the Oil Technology Group Partnerships created and marketed to the investing public by Heim, Hilpert, Savery, Coppage, Basile, Krause and the Petrotec Entities were part of a single, interrelated and integrated business purportedly engaged in recovery of oil and gas through primary and "enhanced" oil recovery technologies and the further development of such technologies.

24. Although interests in the Oil Technology Group Partnershps were sold throughout the United States, no registration statement was ever filed with the Securities and Exchange Commission or made effective for any of these lim-

ited partnerships. The confidential memoranda which were prepared and distributed by the Petrotec Entities for the limited partnerships enumerated in paragraphs 12(a)-(c) claimed that the interests being offered thereunder were exempt from the registration requirements of the Securities Act on the ground that they were "private placements" made pursuant to Section 4(2) of the Securities Act. These representations were materially false and misleading. Each of the partnerships was part of a single plan of financing. The operations of all of the partnerships were so thoroughly entwined that it was and is impossible to accurately divide assets among the partnerships. The assets and funds of each partnership were commingled with the assets of each other partnership. Furthermore, each of the securities was offered by the same issuer, each involved the same class of security, each involved the same consideration for the purchase of interests, *i.e.*, cash, promissory notes and long-term obligations, and each had the same general purpose. In addition, many were offered at or about the same time.

25. Interests in the partnerships were offered for sale to investors in one continuous offering through the means of interstate commerce and the mails by various underwriters, brokers and financial planners located throughout the country. The activities of the underwriters, brokers and financial planners were supervised and coordinated by the Petrotec Entities and by Savery, Coppage, Basile and Krause. Prior to the offer and sale of any partnership interests, the Petrotec Entities supplied the underwriters and brokers with so-called summary "due diligence manuals" containing confidential memoranda and subscription agreements, which manuals and memoranda were prepared by the Petrotec Entities and the individual general partners, with the assistance of the Accounting Defendants, the Attorney Defendants, and the Consulting Defendants.

PARTNERSHIP ORGANIZATION AND OPERATIONS

26. The confidential memoranda for all the Oil Technology Group Partnerships were virtually identical in all respects. Each represented that the partnerships would: (a) engage in the business of acquiring, developing and operating existing wells on proven oil and gas properties; and (b) apply certain EOR technologies to increase production from said properties. Each confidential memorandum also represented that the objectives of the partnerships were: (a) to produce to investors, in the years in which they made cash capital contributions, tax deductions in excess of the amount of said contributions; and (b) to produce a return on investors' capital in future years.

27. Investments in Drake, Vulcan, Vanguard, Dillon and Crowne were made as follows: each investor purchased a minimum of one (1) unit, at $150,000 per unit. Each unit required an initial cash contribution of $12,500 and the execution of two (2) full recourse promissory notes in the face amount of $12,500 each, payable April 15, 1982 and April 15, 1983, respectively. In addition, each unit required the investor to enter into full recourse, long-term obligations to the partnership payable as follows: $20,000 on December 31, 1994 and December 31, 1995, respectively, and $72,500 on December 31, 1996.

28. Investments in Derringer 1981 and in certain of the Wichita Partnerships were made as follows: each investor purchased a minimum of two (2) units, at $75,000 per unit. Units were offered on two payment schedules, as described below.

(a) Under the "standard schedule," each unit required an initial cash contribution of $6,750 and the execution of four (4) full recourse promissory notes. The first note, in the face amount of $6,750, was payable April 15, 1982. The remaining three (3) notes, in the face amount of $1,750 each, were payable on April 15, 1983, April 15, 1984 and April 15, 1985. In addition, each unit required the investor to enter into full recourse, long-term obligations payable as follows: $10,000 on December 31, 1994 and December 31, 1995, and $36,250 payable on December 31, 1996.

(b) Under the "alternative schedule," payments were identical to those under the "standard schedule," except that the initial cash contribution was in the amount of $10,000 and the promissory note due April 15, 1982 was in the face amount of $3,500.

29. Investments in Carlton were made as follows: each investor purchased a minimum of one (1) unit, at $43,650 per unit. Each unit required an initial cash contribution of $5,000 and the execution of two (2) full recourse promissory notes in the face amount of $5,000 each, payable April 15, 1984 and April 15, 1985. In addition, each unit required the investor to enter into full recourse, long-term obligations payable as follows: $8,250 on December 31, 1987, and three payments of $6,800 due December 31, 1992, December 31, 1993 and December 31, 1994.

30. Each investor in the Manhattan and Denver Partnerships syndicated in 1979 purchased a minimum of one (1) unit, at $150,000 per unit. Each unit required an initial cash contribution of $10,000 and the execution of two (2) full recourse promissory notes in the face amount of $10,000 each, payable March 1, 1980 and March 1, 1981. In addition, each unit required the investor to enter into four (4) full recourse promissory notes in the face amount of $30,000 each, all payable March 1, 2007.

31. Each Investor in the Manhattan Partnerships syndicated in 1980 purchased partnership units pursuant to three (3) payment schedules, as described below.

(a) The first schedule required a minimum purchase of one (1) unit, at $230,000 per unit. Each unit purchased pursuant to this schedule required an initial cash contribution of $10,000 and the execution of two (2) full recourse promissory notes in the face amount of $10,000 each, payable March 1, 1981 and March 1, 1982. In addition, each unit required the investor to enter into long-term obligations payable as follows: $30,000 payable on December 31, 1992, December 31, 1993, December 31, 1994 and May 31, 1995, and $80,000 payable on December 31, 2005. Of the $200,000 in long-term obligations, $120,000 was with full recourse to all assets of the limited partners and

$80,000 was without recourse to the assets of the limited partners.

(b) The second schedule required a minimum purchase of one (1) unit, at $230,000 per unit. Each unit purchased pursuant to this schedule required an initial cash contribution of $10,000 and the execution of three (3) full recourse promissory notes, the first two (2) in the face amount of $10,000 each, payable March 1, 1981 and March 1, 1982, and the third in the face amount of $7,500, payable March 1, 1983. In addition, each unit required the investor to enter into long-term obligations payable as follows: $22,500 payable on December 31, 1992, $30,000 payable on December 31, 1993, December 31, 1994 and December 31, 1995, and $80,000 payable on December 31, 2005. Of the $192,500 in long-term obligations, $112,500 was with full recourse to all assets of the limited partners and $80,000 was without recourse to the assets of the limited partners.

(c) The third schedule required a minimum purchase of one (1) unit at $150,000 per unit. Each unit purchased pursuant to this schedule required an initial cash contribution of $10,000, and the execution of three (3) full recourse promissory notes, the first two (2) in the face amount of $10,000 each, payable March 1, 1981 and March 1, 1982, and the third in the face amount of $7,500, payable March 1, 1983. In addition, each unit required the investor to enter into long-term obligations payable as follows: $22,500 payable on December 31, 1992, and $30,000 payable on December 31, 1993, December 31, 1994 and December 31, 1995. Of the $112,500 in long-term obligations, all of said obligations were with full recourse to the assets of the limited partners.

32. Each initial cash capital contribution made by investors and each subsequent capital contribution made pursuant to a promissory note gave rise to a separate investment decision and each such payment therefore constituted a separate purchase of securities. In making said investment decisions, plaintiffs and the other members of the class relied on, *inter alia*, the confidential memoranda, as well as the financial statements, notes

thereto, and tax returns disseminated to them subsequent to making their initial cash capital contributions.

33. All of the Oil Technology Group Partnerships purported to license certain EOR technologies from either Elektra Oil Corporation (*i.e.*, the partnerships initially syndicated in 1979), Elektra Energy Corporation (*i.e.*, the partnerships initially syndicated in 1980), or Hemisphere (*i.e.*, the partnerships initially syndicated in 1981-83). Elektra Oil, Elektra Energy and Hemisphere (collectively referred to herein as "Elektra/Hemisphere") were entities created by Heim, Hilpert, Savery and the Petrotec Entities to further the plan, scheme, conspiracy and common course of conduct. These companies are virtually identical in all respects and, in substance, are one and the same entity. In essence, Elektra Energy assumed Elektra Oil's role in the unlawful scheme beginning in 1980 and Hemisphere assumed Elektra Energy's role in the unlawful scheme beginning in 1981. Elektra/Hemisphere are subsidiaries of defendant Petrotec Systems, A.G., and other of the Petrotec Entities, as hereinabove defined. All three companies operated under the complete dominance and control of Heim, Hilpert, Savery and Rogen. All three companies had and have common officers and directors: Heim, Savery, Rogen, Hilpert and Conklin. Attached hereto as Exhibit B and incorporated herein by this reference is an organizational chart depicting the interrelated nature of the Petrotec Entities and the Oil Technology Group Partnerships.

34. The confidential memoranda for all of the partnerships represented that Elektra/Hemisphere maintained a portfolio of proven and/or useful EOR technologies, many of these technologies purportedly on exclusive license from certain of the other Petrotec Entities. In contrast to the representations in the confidential memoranda, however, the portfolio of EOR technologies was nothing other than a collection of non-existent and/or experimental technologies which had never been successfully field-tested and could not be applied in a commercially feasible manner.

35. Each of the confidential memoranda also represented that Elektra/Hemisphere would sub-license to the partnerships

their EOR technologies in return for the payment by the partnerships of "license fees," which, in total, exceeded $800 million. These license fees were to be paid by the partnerships to Elektra/Hemisphere by means of an annual license fee per partnership unit, plus partnership promissory notes with recourse to partnership and/or limited partners' assets in the event of default.

36. The confidential memoranda pursuant to which units in the partnerships were offered falsely represented that the EOR technologies licensed to the partnerships had a value equal to, or substantially equal to, the amounts paid and to be paid to Elektra/Hemisphere. The truth was that the license fees were paid for non-existent and/or unproven EOR technologies solely to enrich Heim, Hilpert, Savery, Coppage, Basile, Krause and the Petrotec Entities and their agents.

37. Elektra/Hemisphere were represented in the confidential memoranda to be independent entities with no relationship to the Oil Technology Group Partnerships other than that of an arm's-length business relationship. This representation was materially false and misleading. The truth was that Heim, who served at various times relevant herein as president of Elektra/Hemisphere, and who, together with Savery, was the guiding force behind all of the Petrotec Entities, directed and controlled, through their agents, Coppage, Basile and Krause, the activities of all the partnerships, including the business plan of the partnerships and the terms of all contracts entered into by the partnerships, including the contracts between the partnerships and Elektra/Hemisphere. In addition, Heim and Savery were promoters of the partnership interests. As a result of the control exercised by Heim and Savery over Elektra Oil, Elektra Energy, and Hemisphere, as well as over the partnerships, the represented tax deductions were not available to the limited partners from the inception of their investment. Furthermore, in light of the payment by the partnerships of grossly excessive technology licensing fees for non-existent and unproven EOR technologies, it was impossible for the partnerships to ever have been profitable.

38. All of the confidential memoranda for the partnerships represented that investors could expect tax deductions in the years in which they made cash capital contributions in excess of the amount of said cash capital contributions. According to the confidential memoranda, the tax deductions would be achieved in the following manner: the partnerships agreed to pay Elektra/Hemisphere certain license fees for the right to use EOR technology, which license fees were represented to be tax deductible to limited partners. More specifically, the license fees were to be paid by the partnerships to Elektra/Hemisphere partly in cash and partly by promissory note. For example, the 1981 Denver partnerships each paid license fees to Hemisphere, per unit of investment, according to the following schedule:

	Total	*Promissory Note*	*Total*
1981	$3,500	$ 46,400	$ 50,000
1982	2,800	47,200	50,000
1983	2,000	48,000	50,000
1984	-0-	50,000	50,000
1985	-0-	50,000	50,000
	$8,300	$241,700	$250,000

The notes payable to Hemisphere were with annual simple interest of ten percent (10%), maturing on December 31, 2006. In the aggregate, the Denver Partnerships alone agreed to pay in excess of $182 million to Hemisphere as license fees for use of EOR technology, over ninety percent (90%) of this sum to be due in 2006. The confidential memoranda, including the tax opinions contained therein, represented that all of the assets of each of the partnerships, including the promissory notes executed by investors, would be pledged to Elektra/Hemisphere to secure payment of the partnerships' notes to said entities. This purportedly rendered the limited partners personally liable and "at risk," within the meaning of the Internal Revenue Code Section 465, to the technology licensors to the extent of their unpaid capital contributions in the event the partnerships defaulted on any payment due to the licensors. As a result of the substantial expense incurred by the partnerships for the right to use the EOR technology, the confidential memoranda

and the tax opinions contained therein represented that the partnerships would incur losses in their initial years of operation, a portion of which would be deductible to the limited partners because they undertook full recourse obligations which rendered them personally liable to the licensors in the event the partnerships defaulted on their obligations thereto. For example, the confidential memoranda projected that, as a result of the annual payment of $50,000 per unit by the partnerships to Hemisphere for purportedly deductible license fees, limited partners would enjoy a four (4) to one (1) tax deduction based on their contribution of $12,500 in cash in each of the 1981 Denver Partnerships' first three (3) years of operation.

39. Similarly, in the confidential memoranda for the Denver Partnerships syndicated in 1979 and all of the Manhattan Partnerships, it was represented that, in addition to enjoying substantial tax benefits as a result of the partnerships' payments to Elektra/Hemisphere for license fees, investors could also expect tax deductions in the years in which they made cash capital contributions as a result of the partnerships' acquisition of working interests in certain properties purportedly bearing heavy oil represented to be owned by defendant TexOil International Corporation ("TexOil"). To achieve these deductions, the partnerships were to make royalty payments to TexOil, which payments were made by a combination of cash and/or partnership notes. By way of example, the following table sets forth the manner of payment of the royalties, per investment unit, by Boulder Oil and Gas Associates, 1980, one of the Manhattan Partnerships, to TexOil for the period 1980 through 1999:

	1980	*1981*	*1982*	*1983-1999*
TexOil Notes	$4,560	$4,560	$4,560	$5,000 per year
Cash	440	440	440	-0-
	$5,000	$5,000	$5,000	$5,000

The TexOil notes purportedly were secured by partnership assets. Each TexOil note was to mature on December 31, 2005. In the aggregate, the partnerships agreed to pay in excess of $40 million to TexOil as royalty fees for acquisition of the working interests in these purportedly heavy oil-bearing properties, over

98% of this sum to be due in 2005. The confidential memoranda for the Denver Partnerships syndicated in 1979 and for the Manhattan Partnerships, including the tax opinions contained therein, represented that all of the assets of each of these partnerships, including the promissory notes executed by investors, would be pledged to TexOil. Because advanced mineral royalties paid or accrued in connection with mineral properties may be treated by the payor (*i.e.*, the partnerships) as deductions from gross income for the year in which the advanced royalties are paid or accrued, if the conditions of Treasury Regulation § 1.612-3(b)(3) are met, the confidential memoranda represented that investors would be able to deduct a portion of the royalty payments made to TexOil during the year the partnerships made such payments.

40. As a result of the uniform manner in which the partnerships were represented to operate, each of the confidential memoranda contained virtually identical omissions and misrepresentations of material fact. Thus, each of the confidential memoranda for the Oil Technology Group Partnerships were materially false and misleading in the following respects:

(a) The tax benefits represented to be available were not available because, *inter alia*:

(i) The license fees paid and payable to Elektra/Hemisphere were grossly overvalued and were not commercially reasonable;

(ii) The license fees did not constitute ordinary and necessary business expenses;

(iii) The license fees did not constitute deductible research and development expenses under Internal Revenue Code Section 174 because they did not constitute "expenditures" within the meaning of such section;

(iv) The method of payment of the license fees did not satisfy the "at-risk" rules of Internal Revenue Code Section 465;

(v) The advance royalties paid or payable to TexOil did not satisfy the requirements of Treasury Regulation § 1.612-3(b)(3);

(vi) The primary and principal motive of the partnerships was to generate tax benefits, rather than to make a profit. In this connection, given the grossly excessive license fees paid for non-existent and/or ineffectual EOR technology, application of which was incapable of ensuring oil production sufficient to pay off the obligations owed by the partnerships to Elektra/ Hemisphere, it was impossible for the partnerships to make a profit to pass on to investors; and

(vii) Elektra/Hemisphere were related to the partnerships and controlled by defendants Heim, Hilpert and Savery and their agents who, in turn, controlled the partnerships through Coppage, Basile and Krause.

(b) The confidential memoranda omitted to disclose that the business of the partnerships was to be run by the technology licensors and their officers, including but not limited to, Heim, Hilpert, Savery and Rogen, and that this circumstance precluded investors from obtaining the represented tax deductions;

(c) The confidential memoranda omitted to disclose that the business plan of the partnerships was devised by Heim, Savery and the Petrotec Entities, who were represented to be independent "consultants" to the partnerships, rather than promoters;

(d) The confidential memoranda represented that each of the partnerships would conduct its own business, and maintain its own books and records, while in truth, the operations, assets and records of the partnerships have been commingled and entwined from the partnerships' inception;

(e) The confidential memoranda omitted to disclose that the partnerships did not have any systems or procedures of accounting controls adequate to monitor the financial performance of the partnerships;

(f) The confidential memoranda falsely represented that the EOR technology licensed to the partnerships by Elektra/ Hemisphere had a value equal to, or substantially equal to, the amounts paid and to be paid by the partnerships to said defendants;

(g) The confidential memoranda represented that 30%-40% of investor cash would be spent for *bona fide* EOR technology acquisition and research and development, whereas less than 2% of investor cash was spent for those purposes;

(h) The confidential memoranda omitted to disclose that comparable EOR technology was available to the partnerships for significantly less money than the amount which was committed to be paid by the partnerships to Elektra/Hemisphere;

(i) The confidential memoranda omitted to disclose that Elektra/Hemisphere did not in fact have the rights to the represented technologies sufficient to permit them to license such technologies to the partnerships;

(j) The confidential memoranda omitted to disclose that the represented EOR technologies were entirely unproved, had never been field-tested, were experimental and economically infeasible;

(k) The confidential memoranda omitted to disclose that the mineral rights leases purchased by the partnerships were purchased from related parties at grossly inflated prices;

(l) The confidential memoranda omitted to disclose that there had been no discovery of commercially recoverable mineral deposits on any of the oil properties which the partnerships acquired;

(m) The confidential memoranda omitted to disclose that Heim, Savery, the Petrotec Entities and their agents, by virtue of their control of the partnerships, exercised unilateral control over the price to be paid by the partnerships for the purported patented and patentable EOR technologies and over the mineral leases;

(n) The confidential memoranda omitted to disclose that the limited partners were not at risk within the meaning of Internal Revenue Code Section 465 for any amounts in excess of those actually paid in cash by the partnerships to Elektra/Hemisphere and/or TexOil;

(o) The confidential memoranda for the Manhattan Partnerships omitted to disclose that Basile had previously been the subject of an SEC investigation for possible violations of the federal securities laws and, in fact, was sanctioned and criticized by the SEC for his activities in connection with prior securities offerings;

(p) The confidential memoranda falsely represented that the contractual arrangements between the partnerships and Elektra/Hemisphere were the product of arms-length bargaining and the type of business arrangement that might be entered into by a "hard-headed businessman";

(q) The confidential memoranda falsely represented that each partnership would receive an exclusive license from Elektra/Hemisphere to utilize certain technology and that the partnerships could, in certain circumstances, act as a sub-licensor of the technology when, in fact, each partnership received a purportedly "exclusive" license to use the same technology as many of the other partnerships;

(r) The confidential memoranda for the Manhattan Partnerships omitted to disclose that Basile planned to, and did in fact, set aside approximately $7 million of investor money at the inception of the partnerships' business in order to finance an anticipated tax defense, when it was represented that such money was to be used for partnership operations; and

(s) The confidential memoranda for the Denver and Wichita Partnerships syndicated in 1981-1983 omitted to disclose that the promoters thereof knew of the existence of an ongoing Internal Revenue Service tax audit of the Oil Technology Group Partnerships syndicated in previous years, which audit called into question the availability of the represented tax deductions for said partnerships.

41. Each of the tax opinions authored by Baskin & Sears, Friedman & Shaftan, P.C., Somers & Altenbach, Schumacher & Hickey, Frederick R. Schumacher, Ltd., A Professional Law Corporation and Fox & Company and included in the confiden-

tial memoranda for the partnerships, as hereinabove specified, were materially false and misleading because, *inter alia*:

(i) They omitted to disclose that the partnership losses would be disallowed as deductions because the primary motive of the partnerships was to generate tax benefits rather than economic profit;

(ii) They falsely stated that the minimum annual royalties payable to TexOil, and the license fees payable to Elektra/ Hemisphere were reasonable and customary and had a value equal to or in excess of the price paid for them by the partnerships;

(iii) They falsely stated that the amounts payable to TexOil were deductible as minimum annual royalties. Because said amounts were payable in long-term non-recourse notes, absent production sufficient for full payment in cash, this arrangement failed to satisfy the requirements of Treas. Reg. 1.612-(b)(3), which allows a deduction for advance royalties paid or payable pursuant to a minimum royalty provision, defined as requiring that substantially uniform amounts be actually *paid* annually;

(iv) They falsely stated that the minimum annual royalties payable to TexOil and the license fees payable to Elektra/ Hemisphere were deductible pursuant to the accrual method of accounting when, in fact, the notes evidencing these obligations were due so far in the future that payment was improbable;

(v) They falsely stated that the minimum annual royalties payable to TexOil and the license fees payable to Elektra/ Hemisphere met the "clear reflection of income" requirements of the Internal Revenue Code; and

(vi) They falsely stated that the minimum annual royalties payable to TexOil and the license fees payable to Elektra/ Hemisphere satisfied the "at-risk" requirements of the Internal Revenue Code in light of, *inter alia*, the relationship between said entities and the partnerships.

42. The confidential memoranda for the Denver and Wichita Partnerships syndicated in 1981 and 1982 included a title opin-

ion prepared by defendant Houston Harbaugh representing that the oil and gas leasehold working interests located in the Parker Field, Pennsylvania to be acquired by the partnerships were vested in defendant Tulsebond, Ltd. These opinions were materially false and misleading because they failed to disclose the material adverse fact that Tulsebond was controlled by Heim, one of the principal promoters of the partnerships. Moreover, while advising that on the date of Tulsebond's acquisition the properties had been transferred from the original owner to defendant Finagest, A.G. and then to defendant Tamaro Holding, Inc., the title opinions omitted to disclose that these entities, which are defendants herein, were also controlled by Heim and that said transfers between related entities were done for the purpose of concealing Heim's interest in said properties, thereby creating the false impression that the properties were being acquired by the partnerships in arm's-length transactions. The truth was that the properties acquired by the partnerships from Tulsebond were acquired from Heim at grossly inflated prices. For example, leases in the Parker Field, Pennsylvania which commonly sold for $3.00 per acre per year in arm's-length transactions were purchased by the partnerships from Tulsebond for approximately $2,140 per acre. As hereinafter more specifically alleged, Houston Harbaugh knew, or was reckless in not knowing, that Heim controlled Tulsebond, Finagest and Tamaro Holding and knew, or was reckless in not knowing, that Heim's interest therein was concealed for the purpose of misleading investors.

43. (a) Each financial statement audited and opined on by Peat and Fox, as hereinabove specified, and each estimated federal tax savings and cash flow projection rendered by Fox, was materially false and misleading in that each omitted to state or misrepresented the fact that each of the Oil Technology Group Partnerships and the Petrotec Entities was integrated with each other partnership and entity and that the funds and assets of each partnership and entity were being commingled with the assets and funds of other partnerships and entities. The notes to each financial statement audited and opined on by Peat and Fox, as hereinabove specified, were also materially false and

misleading in that they omitted to state or misrepresented the facts concerning the relationship of Elektra/Hemisphere to the partnerships and the Petrotec Entities. In that connection, the financial statements audited and opined upon by Peat and Fox omitted to disclose that, the tax benefits represented to be available would not be (and, in fact, were not) available in light of: (a) the true relationship between Elektra/Hemisphere and the Petrotec Entities and the partnerships and the fact that the technology licensors and their officers, including Heim and Savery, exercised control over partnership operations; (b) the nonexistent and/or unproved EOR technology; (c) the grossly inflated technology licensing fees; (d) the lack of profit motive; and (e) the lack of economic substance to the limited partners' "long-term" obligations.

(b) Both Peat and Fox participated in the preparation of the confidential memoranda in which their names appeared. With respect to Peat, each of said confidential memoranda state that, "Peat, Marwick, Mitchell & Co., Denver, Colorado, has agreed to perform accounting services for the partnership, including the preparation of tax returns, and audited financial statements." With respect to Fox, similar statements appeared in certain of the confidential memoranda with which Fox was associated. Prior to consenting to the use of their names and, in the case of Fox, its opinions and projections in the confidential memoranda, Peat and Fox undertook a review of said confidential memoranda to determine whether or not to consent to the use of their names and/or opinions and projections in such offerings. Prior to giving such consent, Peat and Fox also investigated the management of the partnerships. By having consented to the use of their names and, in Fox's case, its opinions and projections in the confidential memoranda, and performing the investigation described above, Peat and Fox had effective control over the contents of the confidential memoranda and the occurrence of the offerings.

44. Each of the tax returns prepared and disseminated to investors in the partnerships by Peat and Fox, as hereinabove specified, were false and misleading in that each inaccurately and falsely stated that investors in said partnerships were enti-

tled to the tax deductions therein stated. In light of the material adverse facts specified in paragraph 40 hereinabove, such statements were materially false and misleading.

45. The confidential memoranda for each of the Denver and Manhattan Partnerships syndicated in 1979 included a report prepared by defendant CLD Group, Inc. This report purported to identify the best available acreage for oil exploration on, and the amount of recoverable oil located in, the Tar Sand Triangle and Circle Cliffs, Utah and Burnt Hollow, Wyoming. Among other things, this report, in essence, represented that these fields contained significant amonts of oil-in-place which could be recovered on a profitable basis. The report was false and misleading in that the fields did not contain the amounts of oil purported to be recoverable on a profitable basis, as represented therein. In fact, these fields were known to CLD Group, Inc. to be largely depleted and/or commercially unprofitable properties at the time it rendered its opinions. Defendant Vello A. Kuuskraa signed each of the letters accompanying the opinions identified in this paragraph, which letters appeared in the confidential memoranda hereinabove specified.

46. (a) The confidential memoranda for each of the Oil Technology Group Partnerships, except the partnerships syndicated in 1979 and Carlton Oil Technology Partners, Ltd., also included reports prepared by defendant Lewin Energy. With regard to the Manhattan Partnerships, these reports concerned the best available acreage for oil exploitation on, and the amount of recoverable oil located in, the Tar Sand Triangle, and Circle Cliffs, Utah and Burnt Hollow, Wyoming; for the Denver and Wichita Partnerships, these reports concerned the amount of recoverable oil located in the Parker Field, Butler County, Pennsylvania. Among other things, each report, in essence, represented that the fields contained significant amounts of oil-in-place which could be recovered on a profitable basis. Each such report was false and misleading in that the fields did not contain the amounts of oil purported to be recoverable on a profitable basis, as therein represented. In fact, these fields were known to Lewin Energy to be largely depleted—

and/or commercially unprofitable properties at the time it rendered its opinions.

(b) Lewin Energy also provided an opinion entitled "Lewin Energy Corporation Financial Analysis," which opinion appeared in the confidential memoranda for the Denver and Wichita Partnerships syndicated in 1981. Among other things, this opinion, in essence, represented that cash flows from the EOR and primary production acquisition programs for each of these partnerships would result in substantial profits to the limited partners. For example, Lewin Energy projected, for Drake Oil Technology Partners, 1981, that by 1996 the investment would generate $514,000 per unit of reinvestment, note repayment and interest for each of the limited partners in Drake and, by 1996, approximately $350,000 per unit cash disbursement to each of the limited partners. In addition, the report for Drake represented that by the year 2006, funds of $710,000 per unit would be available for each limited partner. These projections were based on assumptions as to the price of oil and the effectiveness of the EOR technology for which Lewin Energy had no reasonable basis and in which Lewin did not have a genuine belief. The financial analysis report was also based on the assumption that the partnerships would be able to acquire conventionally producing oil properties with five year after-tax payback schedules, *i.e.*, that the properties could be fully paid for after five years of production therefrom. Lewin Energy then reported that all of the transactions with which it had previous experience involved payback schedules of less than five years, but that in connection with its report on the payback schedules for the partnerships' properties, it was relying on the representations of Herbert D. Frye of Northbrook Corporation, the partnerships' primary acquisition program contractor, that suitable properties were available with five year payback schedules. Lewin Energy's reliance on this assumption was unreasonable because neither Frye nor Northbrook Corporation had any prior experience in acquiring producing oil properties, let alone evaluation of payback schedules. Lewin Energy either undertook no independent investigation to determine the qualifications of Frye and/or Northbrook and therefore had no

reasonable basis to rely on his representations, or was reckless in performing such investigation. The truth was that Frye and Northbrook were retained by the partnerships at the behest of defendant Savery, over the objections of the general partner, defendant Coppage, who did not believe Frye or Northbrook had the necessary expertise to assist the partnerships. Defendant Vello A. Kuuskraa signed each of the letters accompanying the opinions identified in this paragraph, which letters appeared in the confidential memoranda hereinabove specified.

47. The confidential memoranda for each of the Denver and Wichita Partnerships syndicated in 1981-1982 included an opinion prepared by defendant Technology Catalysts, Inc. on the portfolio of technologies that Hemisphere made available for license to these partnerships. These opinions, in essence, represented that Hemisphere's portfolio of EOR technologies offered "the best opportunity in the United States, and possibly the world for oil and gas limited partnerships and independent oil operators to acquire the processes and systems that are necessary to optimize the profitability of enhanced oil recovery projects," and that the pricing of the technologies was fair, competitive and reasonable. These opinions were false and misleading in that Hemisphere's portfolio of EOR technologies consisted of nothing more than non-existent and/or unproven and untested processes which were otherwise available in the public domain and which were grossly overvalued. Technology Catalyst's opinion was rendered without a genuine belief in its truthfulness and without a reasonable basis in that R.L. DiCicco, president of Hemisphere, was a long-standing friend of defendant Savery, who provided the opinion to Savery without investigating its accuracy or truthfulness, in return for payment of substantial sums of money by Savery and Hemisphere to DiCicco and Technology Catalysts. Defendant R.L. DiCicco signed each of these opinions on behalf of Technology Catalysts, Inc., which opinions appeared in all of the confidential memoranda for the Denver and Wichita Partnerships.

DISCOVERY AND CONCEALMENT

48. Plaintiffs did not discover, nor in the exercise of ordinary and reasonable care and due diligence could they have discovered, the acts, practices, concerted scheme, plan, conspiracy and common course of conduct hereinabove alleged until late 1984, when they received preliminary information that the Internal Revenue Service intended to disallow all of the tax deductions claimed by members of the plaintiff class. Plaintiffs had no access to the documents evidencing the acts, practices, concerted scheme, plan, conspiracy, or common course of conduct herein complained of. Defendants also helped to prevent discovery through their acts of fraudulent concealment which included, *inter alia*, the paying of distribution to investors, the dissemination of annual audited financial statements and tax returns to investors, which statements and returns were false and misleading as hereinabove alleged, the dissemination of status reports on partnership activities to investors and the failure of defendants to correct their misleading and false representations when they were placed on notice of their falsity.

FIRST CLAIM

FOR VIOLATION OF SECTION 10(b) OF THE SECURITIES EXCHANGE ACT OF 1934 AND RULE 10b-5 THEREUNDER

49. Plaintiffs reallege and incorporate herein by this reference each and every allegation contained in paragraphs 1 through 48.

50. This First Claim is based upon Section 10(b) of the Exchange Act and Rule 10b-5 promulgated thereunder and is brought by plaintiffs, on behalf of themselves and the members of the class, against all defendants.

51. All of the defendants, singularly and in concert, engaged or participated in a plan, concerted scheme, conspiracy and common course of conduct directed against the plaintiffs and other members of the class, pursuant to which they knowingly

and/or recklessly engaged in acts, transactions, practices and courses of business which operated as a fraud upon the plaintiffs and other members of the class and made various untrue statements of material fact and omitted to state material facts necessary in order to make the statements made, in light of the circumstances under which they were made, not misleading to the plaintiffs and other members of the class. The purpose, nature and effect of said plan, concerted scheme, conspiracy and common course of conduct was to induce plaintiffs and the members of the class to purchase interests in the Oil Technology Group Partnerships.

52. Said plan, scheme, conspiracy and common course of conduct commenced sometime in 1979, when the first Oil Technology Group Partnerships were syndicated, and continues to the present. During this period, defendants, pursuant to said plan, scheme, conspiracy and common course of conduct, knowingly and recklessly issued, caused to be issued, agreed to, ratified and participated in the issuance of and/or aided and abetted the issuance of, false and misleading statements to the investing public, which statements were material and contained in, *inter alia*, the confidential memoranda for the Oil Technology Group Partnerships, the tax opinions, tax returns, title opinions, geologic and financial analyses, opinions on the portfolio of EOR technology purportedly made available by Elektra/Hemisphere, and financial statements and notes thereto disseminated to investors.

53. The material facts omitted or misrepresented in said documents, as more specifically described in paragraph 40 hereof, concern:

(a) The non-existent, unproven, and/or commercially infeasible EOR technology;

(b) The nature and amount of license fees paid and payable to Elektra/Hemisphere for use of EOR technology;

(c) The availability of the represented tax deductions in light of the true facts concerning the license fees paid to Elektra/Hemisphere;

(d) The availability of the represented tax deductions in light of the true facts concerning the minimum royalties paid to Tex-Oil;

(e) The ability of the Oil Technology Group Partnerships to operate profitably and to produce a return of capital to investors;

(f) The integrated nature of the Oil Technology Group Partnerships and the Petrotec Entities and the commingling of their funds;

(g) The relationship between the Petrotec Entities, the partnerships and Elektra/Hemisphere and the effect of said relationship on the availability of the represented tax deductions; and

(h) The nature and amount of money paid by the partnerships to related entities for mineral rights.

54. The Oil Technology Group Partnerships and the Petrotec Entities were principals in connection with said plan, concerted scheme, conspiracy and common course of conduct, and knew, or were reckless in not knowing, of the omissions and misrepresentations of material fact hereinabove alleged. Each of said entities and partnerships were owned, controlled and managed by the Individual Defendants who, as set forth in paragraphs 55-56 below, knew, or were reckless in not knowing, of said omissions and misrepresentations of material fact. The partnerships and Petrotec Entities acted through those Individual Defendants who were associated and affiliated with such partnerships and entities, as herein alleged, and the knowledge and conduct of such Individual Defendants is therefore imputed to such partnerships and entities.

55. The Individual Defendants identified in this paragraph were principals in connection with the foregoing alleged plan, concerted scheme, conspiracy and common course of conduct, and each such Individual Defendant knew, or was reckless in not knowing, that the documents disseminated to investors in connection with their purchases of interests in the Oil Technol-

ogy Group Partnerships were materially false and misleading in the respects hereinabove alleged.

(a) *Werner Heim* was the moving force behind the Petrotec organization and, as such, participated in all of the acts and practices herein alleged from 1979 and continuing to the present. Heim not only controlled the Petrotec Entities by reason of stock ownership and otherwise, but, along with defendants Savery and Hilpert, originated the idea behind the syndication of the Oil Technology Group Partnershps. Heim participated in all major decisions with respect to the syndication and operation of the partnerships, including, but not limited to, the amount of license fees to be paid by the partnerships to Elektra/Hemisphere for EOR technology. Heim knew that the partnerships could never operate profitably and that the EOR technology licensed to the partnerships by Elektra/Hemisphere was non-existent and/or unproven and grossly overvalued. Heim also knew that Elektra/Hemisphere's independence was critical to the availability of tax deductions claimed by investors and that for the represented tax deductions to be available, said entities could not be deemed to be the agents of the partnerships nor could they exercise effective control over the operations of the partnerships. As one of the originators of the plan, concerted scheme, conspiracy and common course of conduct, Heim knew that the operations of the partnerships and that of Elektra/Hemisphere simply constituted a vehicle for the misappropriation of investors' money. As part of this scheme, Heim, in concert with others, caused numerous foreign entities he controlled to be utilized to receive and secrete the huge sums of investor money collected by the partnerships. For example, Tulsebond, Ltd., which is a British corporation controlled by Heim, received the monies from the grossly inflated prices paid by the Denver and Wichita Partnerships for the Parker Field properties. Heim caused his interest in these properties to be concealed by transferring them from himself and his agent, defendant Conklin, to Finagest, A.G., a Swiss company he controlled, then to Tamaro Holding, a Panamanian company he controlled, and finally to Tulsebond, which he also controlled. As a result of the foregoing and by reason of

his rcle as one of the originators of the scheme and conspiracy herein alleged, Heim knew, or was reckless in not knowing, of all the omissions and misrepresentations of material fact hereinabove alleged.

(b) *Winsor T. Savery* participated in the plan, concerted scheme, conspiracy and common course of conduct hereinabove alleged from its inception in 1979 and continues to participate therein to the present. At various times, Savery was president and/or chairman of the board of Hemisphere, Elektra Oil and Elektra Energy. In such positions, Savery was a member of the senior management of the Petrotec organization. Savery directed the day-to-day operations of the partnerships, including dictating the terms of partnership contracts with the technology licensors and with third party consultants, by, *inter alia*, using threats of removing the individual general partners if the terms of the contracts proposed by Savery were not agreed to. Savery knew that Elektra/Hemisphere's independence was critical to the availability of tax deductions claimed by investors and that, in order for the represented tax deductions to be available, said entities could not be deemed to be the agents of the partnerships nor could they exercise effective control over the operations of the partnerships. Savery was also responsible for commingling the funds of the various entities and partnerships. In his position, Savery knew that the partnerships could never operate profitably, that he and the Petrotec organization controlled Elektra/Hemisphere, and that the EOR technology licensed to the partnerships by Elektra/Hemisphere was non-existent and/or unproven and grossly overvalued. Savery knew that Elektra/Hemisphere were merely conduits for the commingling and misappropriation of investors' money. Savery not only knew that partnership properties were acquired from entities controlled by Heim in non-arm's length transactions for the purpose of concealing Heim's interest in these entities but actually assisted in such transfers. In short, Savery directed the day-to-day operations of the Petrotec organization and, as a result, either knew, or was reckless in not knowing, of all the omissions and misrepresentations of material fact hereinabove alleged.

(c) *Louis F. Coppage* joined the plan, concerted scheme, conspiracy and common course of conduct from its inception in 1979 and continues to participate therein to the present. Coppage, a former insurance salesman, caused to be formed, with the advice and encouragement of Heim and Savery, defendant American Energy Resources, Inc. and its affiliated entity, AER Investments, Inc., for the purpose of acting as the corporate general partner of certain of the Oil Technology Group Partnerships. Coppage also serves as an individual general partner in all of the Denver Partnerships. As a general partner, Coppage is impressed with a fiduciary duty to the partnerships and their limited partners, including the duty of full disclosure in connection with the offer and sale of partnership interests and the conduct of the partnerships' affairs. Because of this fiduciary duty, Coppage was obligated to investigate and ensure that the representations made in the documents disseminated to investors in connection with their purchases of partnership interests were not false or misleading and that no material fact necessary to make the statements therein made not misleading was omitted. Accordingly, Coppage was responsible for the accuracy of the representations made to investors and, as such, knew, or was reckless in not knowing, of the omissions and misrepresentations of material fact herein alleged. More specifically, Coppage knew, or was reckless in not knowing, *inter alia*, that the Denver partnerships could never operate profitably, that the EOR technology licensed to the partnerships was nonexistent and/or unproven and grossly overvalued and that Heim, Savery, the Petrotec Entities over which they exercised control, including Elektra/Hemisphere, directed the operations of the partnerships, including the terms of all partnership contracts and the identity of partnership consultants. Coppage knew that Elektra/Hemisphere's independence was critical to the availability of tax deductions claimed by investors and that, in order for the represented tax deductions to be available, said entities could not be deemed to be the agents of the partnerships nor could they exercise effective control over the operations of the partnerships. Coppage also knew, at the time he participated in the syndication of the Denver partnerships in 1981-1983, that the 1979 partnerships for which he served as general

partner were undergoing an IRS audit that potentially threatened the deductions claimed by investors, yet failed to disclose the fact of the IRS audit to investors in the subsequently syndicated partnerships for which he served as general partner.

(d) *Richard B. Basile* joined the plan, concerted scheme, conspiracy and common course of conduct from its inception in 1979 and continues to participate therein to the present. Basile serves as an individual general partner in all of the Manhattan Partnerships. As a general partner, Basile is impressed with a fiduciary duty to the partnerships and their limited partners, including the duty of full disclosure in connection with the offer and sale of partnership interests and the conduct of the partnerships' affairs. Because of this fiduciary duty, Basile was obligated to investigate and ensure that the representations made in the documents disseminated to investors in connection with their purchases of partnership interests were not false or misleading and that no material fact necessary to make the statements therein made not misleading was omitted. Accordingly, Basile was responsible for the accuracy of the representations made to investors and, as such, knew, or was reckless in not knowing of the omissions and misrepresentations of material fact herein alleged. More specifically, Basile knew, or was reckless in not knowing, *inter alia*, that the Manhattan Partnerships could never operate profitably, that the EOR technology licensed to the partnerships by Elektra Oil and Elektra Energy was non-existent and/or unproven and grossly overvalued and that Heim, Savery, the Petrotec Entities over which they exercised control, including Elektra Oil and Elektra Energy, directed the operations of the partnerships, including the terms of all partnership contracts and the identity of partnership consultants. Basile also knew that Elektra/Hemisphere's independence was critical to the availability of tax deductions claimed by investors and that, in order for the represented tax deductions to be available, said entities could not be deemed to be the agents of the partnerships nor could they exercise effective control over the operations of the partnerships. In addition, Basile knew of his previous sanctioning by the SEC, and that he

intended to create a fund of investor money from the inception of the partnerships to finance an anticipated tax defense.

(e) *Gary E. Krause* joined the plan, concerted scheme, conspiracy and common course of conduct sometime in 1981 and continues to participate therein to the present. Krause, an attorney, caused to be formed, with the advice and encouragement of Heim and Savery, defendant Energy Associates, Inc. for the purpose of acting as the corporate general partner of certain of the Oil Technology Group Partnerships. Krause also serves as the individual general partner in all of the Wichita partnerships. As a general partner, Krause is impressed with a fiduciary duty to the partnerships and their limited partners, including the duty of full disclosure in connection with the offer and sale of partnership interests and the conduct of the partnerships' affairs. Because of this fiduciary duty, Krause was obligated to investigate and ensure that the representations made in the documents disseminated to investors in connection with their purchases of partnership interests were not false or misleading and that no material fact necessary to make the statements therein made not misleading was omitted. Accordingly, Krause was responsible for the accuracy of the representations made to investors and, as such, knew, or was reckless in not knowing, of the omissions and misrepresentations of material fact herein alleged. More specifically, Krause knew, or was reckless in not knowing, *inter alia*, that the Wichita Partnerships could never operate profitably, that the EOR technology licensed to the partnerships by Hemisphere was non-existent and/or unproven and grossly overvalued and that Heim, Savery, the Petrotec Entities over which they exercised control, including Hemisphere, directed the operations of the partnerships, including the terms of all partnership contracts and the identity of partnership consultants. Krause also knew that Elektra/Hemisphere's independence was critical to the availability of tax deductions claimed by investors and that, in order for the represented tax deductions to be available, said entities could not be deemed to be the agents of the partnerships nor could they exercise effective control over the operations of the partnerships.

(f) *Neil E. Rogen* participated in the plan, concerted scheme, conspiracy and common course of conduct hereinabove alleged from 1980 and continued to participate therein until sometime in 1984, the exact dates being unknown to plaintiffs. At various times, Rogen served as president of Elektra Energy and Hemisphere and president of Petroleum Sciences, Inc., which was purportedly a wholly-owned subsidiary of Hemisphere. In addition, Rogen also consented to the use of his name in the confidential memoranda for the Manhattan Partnerships syndicated in 1980 and the Denver and Wichita Partnerships syndicated in 1981-1982 as an expert in the licensing, commercialization and transfer of coal, oil and metallurgical technologies. Rogen also carried out the day-to-day business of Elektra/Hemisphere, including meeting and corresponding with the general partners concerning partnership operations, communicating with so-called EOR experts to attempt to retain their services, and ensuring the collection of license fees purportedly payable by the partnerships to Elektra/Hemisphere. In such positions, and as a result of such conduct, Rogen was obligated to investigate the accuracy of the representations in such confidential memoranda and, as a result, knew, or was reckless in not knowing, that the partnerships could never operate profitably, that the EOR technology licensed to the partnerships by Elektra Energy and Hemisphere was non-existent and/or unproven and grossly overvalued, and that Heim, Savery, the Petrotec Entities over which they exercised control, including Elektra Energy and Hemisphere, directed the operations of the partnerships, including the terms of all partnership contracts and the identity of partnership consultants. Rogen also knew, or was reckless in not knowing, that Elektra Energy's and Hemisphere's independence was critical to the availability of tax deductions claimed by investors and that, in order for the represented tax deductions to be available, said entities could not be deemed to be the agents of the partnerships nor could they exercise effective control over the operations of the partnerships.

(g) *Max W. Hilpert* participated in the plan, concerted scheme, conspiracy and common course of conduct hereinabove alleged from its inception in 1979 and continues to partic-

ipate therein to the present. At various times, Hilpert served as chairman of the board and/or president of various of the Petrotec Entities, including Petrotec Systems, A.G. and PTI Petrotec. In such positions, Hilpert had access to the books and records of the Petrotec Entities and was privy to the negotiations and discussions involving Heim and Savery respecting the conspiracy herein alleged and, as a result, knew, or was reckless in not knowing, of the omissions and misrepresentations of material fact hereinabove alleged. More specifically, Hilpert knew, or was reckless in not knowing, *inter alia*, that Heim, Savery and the Petrotec Entities over which they exercised control, including Elektra/Hemisphere, directed the operations of the partnerships, including the terms of all partnership contracts and the identity of partnership consultants. Hilpert also knew, or was reckless in not knowing, that Elektra/Hemisphere's independence was critical to the availability of tax deductions claimed by investors and that, in order for the represented tax deductions to be available said entities could not be deemed to be the agents of the partnerships nor could they exercise effective control over the operations of the partnerships. Hilpert also knew, or was reckless in not knowing, that the EOR technology licensed to the partnerships by Elektra/Hemisphere was non-existent and/or unproven, was grossly overvalued and had never been successfully field-tested, that the funds and assets of the partnerships were commingled and that there were inadequate controls over the partnerships' financial affairs. In addition, Hilpert knew, or was reckless in not knowing, that partnership properties were purchased from Heim and the Petrotec Entities in non-arm's length transactions at grossly inflated prices.

(h) *Todd Michael Doscher* participated in the plan, concerted scheme, conspiracy and common course of conduct hereinabove alleged from its inception in 1979 and continues to participate therein to the present. At various times, Doscher, a petroleum engineer, purportedly served as a consultant to the partnerships and to Elektra/Hemisphere on EOR technology, and consented to the use of his name in the confidential memoranda. In addition, Doscher also knew that his name, and the

names of companies he controlled, including CLD Group, Inc., and The Doscher Group, Inc. were used in the confidential memoranda pursuant to which interests in the partnerships were offered and sold. In such capacity, and by reason of such conduct, Doscher had an obligation to investigate the representations contained in such confidential memoranda, and, as a result, knew, or was reckless in not knowing, that the EOR technology licensed to the partnerships was non-existent and/or unproven and was grossly overvalued and that the partnerships could never operate profitably. Furthermore, the terms of Doscher's agreements with Elektra Energy, Hemisphere and/or Petroleum Sciences provided that Doscher would receive additional compensation, in addition to his consulting fees, based on the number of partnership units sold. Accordingly, Doscher was a promoter of the partnerships and therefore was obligated to investigate and ensure that the representations in the confidential memoranda were not false or misleading and that no material fact necessary to make the statements therein made not misleading was omitted. As a result, Doscher knew, or was reckless in not knowing, of the omissions and misrepresentations of material fact hereinabove alleged.

(i) *T. Kenneth Pyles* participated in the plan, concerted scheme, conspiracy and common course of conduct hereinabove alleged in 1983, the exact dates being unknown to plaintiffs. Pyles served as president and chief executive officer of AER in 1983. As a result, Pyles, who also was an attorney and certified public accountant, knew that AER served as a general partner of certain of the partnerships, and as president of AER, was impressed with a fiduciary duty to those partnerships and its limited partners, including the duty of full disclosure in connection with the offer and sale of partnership interests and the conduct of the partnerships' affairs. Because of this fiduciary duty, Pyles was obligated to investigate and ensure that the representations made in the documents disseminated to investors in connection with their purchase of partnership interests were not false or misleading and that no material facts necessary to make the statements therein made not misleading were omitted. Accordingly, Pyles was responsible for the accuracy of the rep-

resentations made to investors, and, as a consequence knew, or was reckless in not knowing, of the omissions and misrepresentations of material fact hereinabove alleged. More particularly, during his tenure as an officer of AER, Pyles knew, or was reckless in not knowing, *inter alia*, that Heim, Savery and the Petrotec Entities over which they exercised control, including Hemisphere, directed the operations of the partnerships, including the terms of all partnership contracts. Pyles knew, or was reckless in not knowing, that Hemisphere's independence was critical to the availability of tax deductions claimed by investors and that, in order for the represented tax deductions to be available, that said entity could not be deemed to be the agent of the partnerships nor could it exercise effective control over the operations of the partnerships. Pyles also knew, or was reckless in not knowing, that the EOR technology licensed to the partnerships by Hemisphere was non-existent and/or unproven and was grossly overvalued, that the funds and assets of the partnerships were commingled and that there were inadequate controls over the partnerships' financial affairs. By reason of his position as president of AER and his insider knowledge of the partnerships' transactions, Pyles had a duty to disclose the material adverse information detailed above.

(j) *Greg E. Bogdan* participated in the plan, concerted scheme, conspiracy and common course of conduct hereinabove alleged during the period 1981 through 1983, the exact dates being unknown to plaintiffs. During the foregoing period Bogdan, a certified public accountant, served as president of AER Investments and vice president of finance of AER. In such positions, Bogdan knew, or was reckless in not knowing, that Heim, Savery and the Petrotec Entities over which they exercised control, including Hemisphere, directed the operations of the partnerships, including the terms of all partnership contracts and the identity of partnership consultants, that Hemisphere's independence was critical to the availability of tax deductions claimed by investors and that, in order for the represented tax deductions to be available that said entity could not be deemed to be the agent of the partnerships nor could it exercise effective control over the operations of the partnerships.

Bogdan also knew, or was reckless in not knowing, that the EOR technology licensed to the partnerships by Hemisphere was non-existent and/or unproven and was grossly overvalued, that the funds and assets of the partnerships were commingled and that there were inadequate controls over the partnerships' financial affairs. By reason of his position as an officer of AER and AER Investments and his insider knowledge of the partnerships' transactions, Bogdan had a duty to disclose the material adverse information detailed above.

(k) *James A. Cunningham* participated in the plan, concerted scheme, conspiracy and common course of conduct hereinabove alleged from 1981 and continued to participate therein until sometime in 1984, the exact dates being unknown to plaintiffs. During the foregoing period, Cunningham served as president of AER and a member of the board of directors, and one of the principal stockholders, in AER Investments. In such positions, and by virtue of his access to key documentary material, Cunningham either knew, or was reckless in not knowing, that Heim, Savery and the Petrotec Entities over which they exercised control, including Hemisphere, directed the operations of the partnerships, including the terms of all partnership contracts and the identity of partnership consultants. Cunningham also knew, or was reckless in not knowing, that Hemisphere's independence was critical to the availability of tax deductions claimed by investors and that, in order for the represented tax deductions to be available, said entity could not be deemed to be the agent of the partnerships nor could it exercise effective control over the operations of the partnerships. Cunningham also knew, or was reckless in not knowing, that the EOR technology licensed to the partnerships by Hemisphere was non-existent and/or unproven and grossly overvalued and had never been successfully field-tested, that the funds and assets of the partnerships were commingled and that there were inadequate controls over the partnerships' financial affairs. By reason of his position as an officer and director of AER and his insider knowledge of the partnerships' transactions, Cunningham had a duty to disclose the material adverse information detailed above.

56. The Individual Defendants identified in this paragraph substantially assisted and thus aided and abetted the foregoing alleged plan, concerted scheme, conspiracy and common course of conduct, and each such defendant knew of the omissions and misrepresentations hereinabove alleged.

(a) *William R. Conklin* joined the plan, concerted scheme, conspiracy and common course of conduct hereinabove alleged sometime during 1980 and continued to participate therein until sometime in 1984, the exact dates being unknown to plaintiffs. Conklin, an attorney, served as Heim's agent in the United States for transacting the business of the Petrotec Entities and also served as an officer of Elektra Energy, Hemisphere and Petroleum Sciences, Inc., which was purportedly a wholly-owned subsidiary of Hemisphere. In addition, Conklin managed the affairs of foreign corporations Heim controlled such as defendants Tulsebond, Ltd., Tamaro Holding, Inc. and Finagest, Ltd. In that connection, Conklin assisted Heim in acquiring the Parker Field properties, which were subsequently acquired by the partnerships from Heim at grossly inflated prices, by negotiating for their acquisition without disclosing on whose behalf he was acting. Conklin also served as an "escrow agent" for the collection of license fees purportedly owed by the partnerships to Elektra Energy and Hemisphere. Conklin maintained a bank account for the benefit of said entities in the name of "William R. Conklin Escrow Agent." As a result of the foregoing, and in his position as agent for said entities, Conklin knew that such fees were paid for the use of non-existent and/or unproven and grossly overvalued EOR technology, solely for the personal enrichment of Heim, Savery and their agents. As a result of the positions he occupied, Conklin also knew that the partnerships could never operate profitably, that the EOR technology licensed to the partnerships by Elektra Energy and Hemisphere was non-existent and/or unproven and grossly overvalued, and that Heim, Savery, the Petrotec Entities over which they exercised control, including Elektra Energy and Hemisphere, directed the operations of the partnerships, including the terms of all partnership contracts and the identity of partnership consultants. Conklin also furthered the fraud by

failing to disclose the information he knew as to the non-existent and/or unproved EOR technology and the undisclosed interest Heim held in entities from which the partnerships acquired the Parker Field properties. Conklin was obligated to disclose said information by virture of his insider relationship as an officer and director of Elektra Energy and Hemisphere. Furthermore, as an officer and director of Elektra Energy and Hemisphere, Conklin consented to and approved of the fraudulent practices in which they engaged, as detailed above. As a result, Conklin rendered substantial assistance to Heim, Savery, the Petrotec Entities and the partnerships in perpetrating, and in helping to conceal the existence of the plan, concerted scheme, conspiracy and common course of conduct hereinabove alleged.

(b) *Robert LaGuardia* participated in the plan, concerted scheme, conspiracy and common course of conduct during the period 1981 through 1984, the exact dates being unknown to plaintiffs. During the foregoing period, LaGuardia, a certified public accountant, served as controller and chief financial officer of AER. In such positions LaGuardia knew that Heim, Savery and the Petrotec Entities over which they exercised control, including Hemisphere, directed the operations of the partnerships, including the terms of all partnership contracts and the identity of partnership consultants. LaGuardia also knew that Hemisphere's independence was critical to the availability of tax deductions claimed by investors and that, in order for the represented tax deductions to be available, said entity could not be deemed to be the agent of the partnerships nor could it exercise effective control over the operations of the partnerships. LaGuardia also knew that the EOR technology licensed to the partnerships by Hemisphere was non-existent and/or unproven and grossly overvalued, that the funds and assets of the partnerships were commingled and that there were inadequate controls over the partnerships' financial affairs. By reason of his position as an officer of AER and his insider knowledge of the partnerships' transactions, LaGuardia had a duty to disclose the material adverse information detailed above. As a result, LaGuardia rendered substantial assistance to AER and the

partnerships in perpetrating, and in helping to conceal the existence of the plan, concerted scheme, conspiracy and common course of conduct hereinabove alleged.

(c) *Darrel D. McCullough* participated in the plan, concerted scheme, conspiracy and common course of conduct from 1981 until sometime in 1984, the exact dates being unknown to plaintiffs. During the foregoing period, McCullough served as vice-president of marketing for AER. As a result of occupying such positions, McCullough knew that Heim, Savery and the Petrotec Entities over which they exercised control, including Hemisphere, directed the operations of the partnerships, including the terms of all partnership contracts and the identity of partnership consultants. McCullough also knew that Hemisphere's independence was critical to the availability of tax deductions claimed by investors and that, in order for the represented tax deductions to be available, said entity could not be deemed to be the agent of the partnerships nor could it exercise effective control over the operations of the partnerships. McCullough also knew that the EOR technology licensed to the partnerships by Hemisphere was non-existent and/or unproven and grossly overvalued, that the funds and assets of the partnerships were commingled and that there were inadequate controls over the partnerships' financial affairs. By reason of his position as an officer and director of AER and his insider knowledge of the partnerships' transactions, McCullough had a duty to disclose the material adverse information detailed above. As a result, McCullough rendered substantial assistance to AER and the partnerships in perpetrating, and in helping to conceal the existence of the plan, concerted scheme, conspiracy and common course of conduct hereinabove alleged.

(d) *C. Norris Taylor, Jr.* participated in the plan, concerted scheme, conspiracy and common course of conduct hereinabove alleged from 1980 to the present, the exact dates being unknown to plaintiffs. During the foregoing period, Taylor, a certified public accountant, served as vice-president, secretary and director of Energy Associates, Inc. As a result of occupying such positions, Taylor knew that Heim, Savery and the Petrotec Entities over which they exercised control, including Hemi-

sphere, directed the operations of the partnerships, including the terms of all partnership contracts and the identity of partnership consultants. Taylor also knew that Hemisphere's independence was critical to the availability of tax deductions claimed by investors and that, for the represented tax deductions to be available, said entity could not be deemed to be the agent of the partnerships nor could it exercise effective control over the operations of the partnerships. Taylor also knew that the EOR technology licensed to the partnerships by Hemisphere was non-existent and/or unproven, was grossly overvalued, that the funds and assets of the partnerships were commingled and that there were inadequate controls over the partnerships' financial affairs. By reason of his position as an officer and director of Energy Associates, Inc. and his insider knowledge of the partnerships' transactions, Taylor had a duty to disclose the material adverse information detailed above. Taylor rendered substantial assistance to Energy Associates and the partnerships in perpetrating, and in helping to conceal the existence of the plan, concerted scheme, conspiracy and common course of conduct hereinabove alleged.

(e) *Erich M. Puhar* participated in the plan, concerted scheme, conspiracy and common course of conduct hereinabove alleged from its inception in 1979 and continuing to the present. At various times, Puhar, a chemical engineer, served as a vice-president and member of the board of directors of Petrotec Systems, A.G., president of Petrogenetics and executive vice-president of PTI Petrotec. As a result of occupying such positions, Puhar knew that Heim, Savery and the Petrotec Entities over which they exercised control, including Elektra/Hemisphere, directed the operations of the partnerships, including the terms of all partnership contracts and the identity of partnership consultants. Puhar also knew that Elektra and Hemisphere's independence was critical to the availability of tax deductions claimed by investors and that, for the represented tax deductions to be available, said entities could not be deemed to be the agents of the partnerships nor could they exercise effective control over the operations of the partnerships. Puhar also knew that the EOR technology licensed to the part-

nerships by Elektra/Hemisphere was non-existent and/or unproven and was grossly overvalued and had never been successfully field-tested, that the funds and assets of the partnerships were commingled and that there were inadequate controls over the partnerships' financial affairs. By reason of his position as an officer and director of Petrotec Entities, Inc. identified above and his insider knowledge of the partnerships' transactions, Puhar had a duty to disclose the material adverse information detailed above. As a result, Puhar rendered substantial assistance to the Petrotec Entities and the partnerships in perpetrating, and in helping to conceal the existence of the plan, concerted scheme, conspiracy and common course of conduct hereinabove alleged.

(f) *Armin Fiechter* participated in the plan, concerted scheme, conspiracy and common course of conduct hereinabove alleged from its inception in 1979 and continuing to the present. At various times, Fiechter, a microbiologist, served on the board of directors of Petrotec Systems, A.G. and PTI Petrotec. Fiechter also served as a consultant, and purportedly directed an EOR research program for Petroleum Sciences. As a result of occupying such positions, Fiechter knew that Heim, Savery and the Petrotec Entities over which they exercised control, including Elektra/Hemisphere, directed the operations of the partnerships, including the terms of all partnership contracts and the identity of partnership consultants. Fiechter also knew that Elektra/Hemisphere's independence was critical to the availability of tax deductions claimed by investors and that, in order for the represented tax deductions to be available, said entities could not be deemed to be the agents of the partnerships nor could they exercise effective control over the operations of the partnerships. Fiechter also knew that the EOR technology licensed to the partnerships was non-existent and/or unproven and grossly overvalued and had never been successfully field-tested, that the funds and assets of the partnerships were commingled and that there were inadequate controls over the partnerships' financial affairs. By reason of his position as an officer and director of various of the Petrotec Entities and his insider knowledge of the partnerships' transactions, Fiechter

had a duty to disclose the material adverse information detailed above. As a result, Fiechter rendered substantial assistance to the Petrotec Entities and the partnerships in perpetrating and helping to conceal the existence of the plan, concerted scheme, conspiracy and common course of conduct hereinabove alleged.

57. Defendant Glenda Exploration and Development Corporation ("GEDCO"), which serves as the corporate general partner for the Manhattan Partnerships and for the 1979 Denver Partnerships, was a principal in connection with the foregoing alleged plan, concerted scheme, conspiracy and common course of conduct and knew, or was reckless in not knowing, that the representations in the confidential memoranda pursuant to which partnership interests were offered and sold were materially false and misleading in the respects hereinabove identified. As a general partner, GEDCO was impressed with a fiduciary duty to the partnerships and their limited partners, including the duty of full disclosure in connection with the offer and sale of partnership interests and the conduct of the partnerships' affairs. Because of this fiduciary duty, GEDCO was obligated to investigate and ensure that the representations made in the documents disseminated to investors in connection with their purchase of partnership interests were not false or misleading and that no material fact necessary to make the statements therein made not misleading was omitted. Accordingly, GEDCO was responsible for the accuracy of the representations made to investors and knew, or was reckless in not knowing, of the omissions and misrepresentations of material fact hereinabove alleged. In addition, GEDCO's actions, conduct and knowledge were derivative of that of its officers, directors and agents who, as hereinabove alleged, knew, or were reckless in not knowing, of the omissions and misrepresentations hereinabove alleged, and thus such actions, conduct and knowledge are imputed to GEDCO.

58. Defendant American Energy Resources, Inc., which serves as the corporate general partner for the Denver partnerships syndicated in 1981-1983, was a principal in connection with the foregoing alleged plan, concerted scheme, conspiracy

and common course of conduct and knew, or was reckless in not knowing, that the representations in the confidential memoranda pursuant to which partnership interests were offered and sold were materially false and misleading in the respects hereinabove identified. As a general partner, American Energy Resources, Inc. was impressed with a fiduciary duty to the partnerships and their limited partners, including the duty of full disclosure in connection with the offer and sale of partnership interests and the conduct of the partnerships' affairs. Because of this fiduciary duty, American Energy Resources, Inc. was obligated to investigate and ensure that the representations made in the documents disseminated to investors in connection with their purchases of partnership interests were not false or misleading and that no material fact necessary to make the statements therein made not misleading was omitted. Accordingly, American Energy Resources, Inc. was responsible for the accuracy of the representations made to investors and knew, or was reckless in not knowing, of the omissions and misrepresentations of material fact hereinabove alleged. In addition, American Energy Resources, Inc.'s actions, conduct and knowledge were derivative of that of its officers, directors and agents who, as hereinabove alleged, knew, or were reckless in not knowing, of the omissions and misrepresentations hereinabove alleged, and thus such actions, conduct and knowledge are imputed to American Energy Resources, Inc.

59. Defendant Energy Associates, Inc., which serves as the corporate general partner for the Wichita Partnerships, was a principal in connection with the foregoing alleged plan, concerted scheme, conspiracy and common course of conduct and knew, or was reckless in not knowing, that the representations in the confidential memoranda pursuant to which partnership interests were offered and sold were materially false and misleading in the respects hereinabove identified. As a general partner, Energy Associates, Inc. was impressed with a fiduciary duty to the partnerships and their limited partners, including the duty of full disclosure in connection with the offer and sale of partnership interests and the conduct of the partnerships' affairs. Because of this fiduciary duty, Energy Associates, Inc.

was obligated to investigate and ensure that the representations made in the documents disseminated to investors in connection with their purchases of partnership interests were not false or misleading and that no material fact necessary to make the statements therein made not misleading was omitted. Accordingly, Energy Associates, Inc. was responsible for the accuracy of the representations made to investors and knew, or was reckless in not knowing, of the omissions and misrepresentations of material fact hereinabove alleged. In addition, Energy Associates, Inc.'s actions, conduct and knowledge were derivative of that of its officers, directors and agents who, as hereinabove alleged, knew, or were reckless in not knowing, of the omissions and misrepresentations hereinabove alleged, and thus such actions, conduct and knowledge are imputed to Energy Associates, Inc.

60. The accounting defendant, Peat, Marwick, Mitchell & Co., was a principal and an aider and abettor in connection with the foregoing alleged plan, concerted scheme, conspiracy and common course of conduct.

(a) Peat was a principal in that it knowingly or recklessly issued reports on audited financial statements and prepared tax returns, as hereinabove specified, which reports and tax returns were disseminated to plaintiffs and the other members of the plaintiff class in connection with their purchases of securities and were materially false and misleading in the respects hereinabove specified. In issuing said statements, defendant Peat knew, or was reckless in not knowing, the facts respecting the relationship of Hemisphere to the Petrotec Entities and to the Oil Technology Group Partnerships, including the fact that Hemisphere was an agent and related party of the Petrotec Entities and the partnerships, that Heim and Savery directed the operations of the partnerships, including the terms of all partnership contracts and the identity of partnership consultants, that the partnerships and Petrotec Entities were integrated, that the funds and assets of the partnerships were commingled, that the partnerships had inadequate and/or nonexistent internal financial controls and that the EOR technology was non-existent and/or unproven and was grossly overvalued.

As a result, the financial statements and notes thereto audited and opined on by Peat and the tax returns prepared by Peat were materially false and misleading in the respects specified in paragraphs 43-44 hereof.

(b) Peat also substantially assisted and thus aided and abetted the fraud hereinabove alleged by participating in the process by which the confidential memoranda for the Denver Partnerships syndicated in 1981-1983 were finalized. By virtue of its review of the confidential memoranda and its investigation of the partnerships' management, as more specifically alleged above, Peat knew of the respects in which the confidential memoranda were false and misleading, and furthered the fraud by consenting to the inclusion of its name in the confidential memoranda which it knew to be false and misleading.

61. The accounting defendant, Fox & Company, was a principal and an aider and abettor in connection with the foregoing alleged plan, concerted scheme, conspiracy and common course of conduct.

(a) Fox was a principal in that it knowingly or recklessly issued summary projections of estimated federal income tax savings and cash flow, tax opinions, and reports on audited financial statements and prepared tax returns, as hereinabove specified, which reports and tax returns were disseminated to plaintiffs and the other members of the plaintiff class in connection with their purchases of securities and were materially false and misleading in the respects hereinabove specified. In issuing said statements, defendant Fox knew, or was reckless in not knowing, the facts respecting the relationship of Elektra Energy and Hemisphere, to the Petrotec Entities and to the Oil Technology Group Partnerships, including the fact that Elektra Energy and Hemisphere were agents and related parties of the Petrotec Entities and the partnerships, that Heim and Savery directed the operations of the partnerships, including the terms of all partnership contracts and the identity of partnership consultants, that the partnerships and Petrotec Entities were integrated, that the funds and assets of the partnerships were commingled, that the partnerships had inadequate and/or non-

existent internal financial controls and that the EOR technology was non-existent and/or unproven and was grossly overvalued. As a result, the federal income tax savings and cash flow projections, the tax opinions and the financial statements and notes thereto audited and opined on by Fox, and the tax returns prepared by Fox were materially false and misleading in the respects specified in paragraphs 43-44 hereof.

(b) Fox also substantially assisted and thus aided and abetted the fraud hereinabove alleged by participating in the process by which the confidential memoranda in which its tax opinions and projections were included, and for the Wichita Partnerships syndicated in 1981, were finalized. By virtue of its review of the confidential memoranda and its investigation of the partnerships' management, as more specifically alleged above, Fox knew of the respects in which the confidential memoranda were false and misleading, and furthered the fraud by consenting to the inclusion of its name in the confidential memoranda which it knew to be false and misleading.

62. In rendering their opinions on the aforementioned financial statements and notes thereto, Peat and Fox represented that their examinations were conducted in accordance with generally accepted auditing standards ("GAAS"), which statement was false because Peat and Fox failed to comply with GAAS in the following respects:

(a) American Institute of Certified Public Accountants ("AICPA") General Standard No. 3 was violated, which standard requires that due professional care be exercised in the performance of the examination and preparation of the report;

(b) AICPA General Standard No. 2 was violated, which standard requires that, in all matters relating to an assignment, an independence in mental attitude is to be maintained by the auditor;

(c) AICPA Standard of Field Work No. 1 was violated, which standard requires that the work is to be adequately planned and assistants, if any, are to be properly supervised;

(d) AICPA Standard of Field Work No. 2 was violated, which standard requires that there be proper study and evaluation of the existing internal controls as a basis for reliance thereon and for the determination of the resultant extent of the tests to which auditing procedures are to be restricted;

(e) AICPA Standard of Field Work No. 3 was violated, which standard requires that sufficient competent evidential material is to be obtained through inspection, observation, inquiries, and confirmations to afford a reasonable basis for an opinion regarding the financial statements under examination;

(f) AICPA Standard of Reporting No. 3 was violated, which standard requires that informative disclosures in the financial statements are to be regarded as reasonably adequate unless otherwise stated in the report;

(g) AU Section 334 respecting the disclosure of related party transactions, and more specifically AU Section 334.17, were violated, which standards require that the following information be disclosed respecting related party transactions that are material:

(i) the nature of the relationship;

(ii) a description of the transactions for the period reported on, including amounts, if any, and such other information as is deemed necessary to an understanding of the effects of the financial statements;

(iii) the dollar volume of transactions and the effects of any change in the method of establishing terms for that used in the preceding period; and

(iv) amounts due from or to related parties and, if not otherwise apparent, the terms and manner of settlement.

63. Defendant CLD Group, Inc. was a principal and an aider and abettor in connection with the foregoing alleged plan, concerted scheme, conspiracy and common course of conduct.

(a) CLD Group, Inc. was a principal in that it knowingly or recklessly issued the geologic reports hereinabove specified,

which reports were materially false and misleading in the respects hereinabove alleged. In connection with rendering said reports, CLD Group was obligated to investigate the accuracy of the representations contained therein, including, but not limited to, the utility and viability of conducting EOR operations on the subject properties, and thus either knew, or was reckless in not knowing, of the respects in which said reports were materially false and misleading. Defendant Vello Kuuskraa, then vice-president and chief financial officer of defendant Lewin and Associates, a major stockholder in CLD Group, Inc. signed the letters accompanying said reports and, as such, was also a principal in connection with the foregoing alleged plan, concerted scheme, conspiracy and common course of conduct and knew, or was reckless in not knowing, that said reports were materially false and misleading in the respects hereinabove alleged.

(b) CLD Group, Inc. also substantially assisted and thus aided and abetted the fraud hereinabove alleged by providing its purported expertise in EOR technology to the partnerships syndicated in 1981-1983. CLD Group's name appears in the confidential memoranda for said partnerships, and the firm is identified as a consultant to the partnerships respecting the use of additives for increasing the recovery of heavy oil. CLD Group, Inc. knew that such additives were commercially infeasible and thus could not be used to assist the partnerships in its purported EOR operations.

64. Defendant Lewin Energy Corporation was a principal in connection with the foregoing alleged plan, concerted scheme, conspiracy and common course of conduct in that it knowingly or recklessly issued the geologic reports and financial analysis reports hereinabove specified, which reports were materially false and misleading in the respects hereinabove alleged. In connection with rendering said reports, Lewin Energy was obligated to investigate the assumptions contained therein, including, but not limited to, the validity of the EOR technology, and thus either knew, or was reckless in not knowing, of the respects in which said reports were materially false and misleading. Defendant Vello Kuuskraa, president of Lewin

Energy, signed the letters accompanying said reports and, as such, was also a principal in connection with the foregoing alleged plan, concerted scheme, conspiracy and common course of conduct and knew, or was reckless in not knowing, that said reports were materially false and misleading in the respects hereinabove alleged. At the time Lewin Energy made its projections, which it knew would be relied upon by plaintiffs, it did not believe they were reliable or had reason to believe that said projections were not reliable.

65. (a) Defendant Lewin and Associates, Inc. substantially assisted and thus aided and abetted the fraud hereinabove alleged. Lewin and Associates was one of three principal stockholders in defendant CLD Group, Inc., which rendered opinions contained in the confidential memoranda for the partnerships syndicated in 1979 respecting the best available acreage for oil exploration, and the amount of recoverable oil located in, the Tar Sand Triangle, and Circle Cliffs, Utah, and Burnt Hollow, Wyoming. Lewin and Associates substantially assisted in the preparation of said reports by providing the expertise of defendant Vello Kuuskraa, then a vice-president and chief financial officer of Lewin and Associates, in the areas of collection of oil and gas geologic and resource data and development of recovery models for EOR processes, to prepare the report and identify the recommended acreages. Lewin and Associates knew that the reports prepared by CLD, with the substantial assistance of Lewin and Associates, were materially false and misleading because the acreages identified therein were known to Lewin and Associates to be largely depleted and/or commercially unprofitable. By agreeing to the inclusion of the geologic reports on the Utah and Wyoming fields in the confidential memoranda, which reports contained information known to Lewin and Associates to be false and misleading, Lewin and Associates thereby furthered the fraud.

(b) Lewin and Associates also substantially assisted and thus aided and abetted the fraud hereinabove alleged by providing its purported expertise in EOR technology to its wholly-owned subsidiary, Lewin Energy, in the course of Lewin Energy's preparation of the geologic and financial analysis reports which

appeared in the confidential memoranda for the Denver and Wichita Partnerships syndicated in 1981-1982, as hereinabove specified, and the Manhattan Partnerships syndicated in 1980. Lewin and Associates knew such reports were materially false and misleading because the acreages identified therein were known to Lewin and Associates to be largely depleted and/or commercially unprofitable properties. Similarly, Lewin and Associates knew such reports were materially false and misleading because they were based on assumptions as to the price of oil and the effectiveness of the EOR technology for which Lewin and Associates had no reasonable basis and in which it did not have a genuine belief. By substantially assisting its subsidiary in preparing the geologic and financial analysis reports on the Parker Field and on the financial consequences of investing in the partnerships, which reports contained information known to Lewin and Associates to be false and misleading, Lewin and Associates not only profited but also furthered the fraud hereinabove alleged.

66. Defendant Technology Catalysts, Inc. was a principal in connection with the foregoing alleged plan, concerted scheme, conspiracy and common course of conduct in that it knowingly or recklessly issued false and misleading opinions on the portfolio of technologies Hemisphere purportedly made available for license to the partnerships with knowledge that said statements would be included in the confidential memoranda and relied on by investors. In connection with rendering said opinions, Technology Catalysts was obligated to investigate the accuracy of the representations contained therein, including, but not limited to, the existence and utility of the EOR technology and thus either knew, or was reckless in not knowing, of the respects in which said opinions were materially false and misleading, as hereinabove alleged. Defendant R. L. DiCicco, president of Technology Catalysts, signed each of the opinions referenced above and, as such, was also a principal in connection with the foregoing alleged plan, concerted scheme, conspiracy and common course of conduct and knew, or was reckless in not knowing, that the opinions respecting the portfolio of technologies that defendant Hemisphere made available for license to the

partnerships were materially false and misleading in the respects hereinabove alleged.

67. Defendant TexOil International Corporation substantially assisted and thus aided and abetted the fraud hereinabove alleged. TexOil made available to the Manhattan partnerships and the Denver partnerships syndicated in 1979 properties that purportedly were oil-bearing in consideration of, *inter alia*, the payment to TexOil of certain minimum annual royalties, the amount of which was dependent on the number of partnership units sold. TexOil, which had no operating history prior to its formation in August 1979, knew, or was reckless in not knowing, that the properties it owned and thereafter sold to the partnerships were not commercially feasible for oil and gas production. By entering into said agreements, which TexOil knew would be included in the confidential memoranda, TexOil, which was a promoter with respect to interests in the Manhattan Partnerships, and the Denver Partnerships syndicated in 1979, rendered substantial assistance to the fraud and the foregoing alleged plan, concerted scheme, conspiracy and common course of conduct.

68. Somers & Altenbach and Robert E. Altenbach were principals and aiders and abettors in connection with the foregoing alleged plan, concerted scheme, conspiracy and common course of conduct.

(a) Somers & Altenbach and Robert E. Altenbach were principals in that they knowingly or recklessly rendered false and misleading tax opinions, as hereinabove specified. In preparing tax opinions for the Denver Partnerships, Somers & Altenbach, and Robert E. Altenbach, were charged by law to investigate the statements made in the confidential memoranda for such partnerships and could not rely solely on the representations of management as to the business plan and operations of the partnerships. As a result, Somers and Altenbach and Robert E. Altenbach knew, or were reckless in not knowing, that their tax opinions were false and misleading since, *inter alia*, the represented tax deductions could not be achieved because (i) Hemisphere was the agent of the partnerships, (ii) Heim, Savery, the

Petrotec Entities over which they exercised control, including Hemisphere, directed the operations of the partnerships, including the terms of all partnership contracts and the identity of partnership consultants, and (iii) the license fees paid by the partnerships to Hemisphere were not "ordinary and necessary" expenses nor "research and development expenditures," all of which facts were known to, or recklessly disregarded by, Somers & Altenbach and Robert E. Altenbach at the time they rendered their tax opinions.

(b) Somers & Altenbach and Robert E. Altenbach also substantially assisted and thus aided and abetted the fraud herein alleged. The firm and Robert E. Altenbach rendered securities advice and opinions to defendants Coppage and AER respecting partnership affairs, including opinions to the effect that the Denver Partnership offerings were not integrated and therefore were not required to be registered with the Securities and Exchange Commission and that the offerings complied with the Commission's Rule 146 respecting non-integration. Somers & Altenbach and Robert E. Altenbach knew that their non-integration opinions were false and misleading because they knew that all of the Denver Partnerships syndicated in 1981-1983 were part of one integrated business controlled by Heim, Savery and Hemisphere. In addition, the firm provided tax assistance letters to the partnerships in which it agreed to defend the partnerships in the event of an IRS challenge to the tax structure set forth in the confidential memoranda, which letters were included in such memoranda as hereinabove specified. Somers & Altenbach and Robert E. Altenbach knew that their tax assistance letters were materially misleading because they knew that the represented tax deductions could not be achieved because, *inter alia*, they knew that Hemisphere was the agent of the partnerships, Heim, Savery and the Petrotec Entities over which they exercised control, including Hemisphere, directed the operations of the partnerships, including the terms of all partnership contracts and the identity of partnership consultants, and because the license fees paid by the partnerships to Hemisphere were not "ordinary and necessary" business expenses nor "research and development" expenditures.

69. Baskin & Sears was a principal and an aider and abettor in connection with the foregoing alleged plan, concerted scheme, conspiracy and common course of conduct.

(a) Baskin & Sears was a principal in that it knowingly or recklessly rendered false and misleading tax opinions as hereinabove specified. In preparing tax opinions for the Manhattan Partnerships, Baskin & Sears was charged by law to investigate the statements made in the confidential memoranda for such partnerships and could not rely solely on the representations of management as to the business plan and operations of the partnerships. As a result, Baskin & Sears knew, or was reckless in not knowing, that its tax opinions were false and misleading since, *inter alia*, the represented tax deductions could not be achieved because (i) Elektra Energy was the agent of the partnerships, (ii) Heim, Savery, the Petrotec Entities over which they exercised control, including Elektra Energy, directed the operations of the partnerships, including the terms of all partnership contracts and the identity of partnership consultants, and (iii) the license fees paid by the partnerships to Elektra Energy were not "ordinary and necessary" business expenses nor "research and development expenditures," all of which facts were known to, or recklessly disregarded by, Baskin & Sears at the time it rendered its tax opinions. Baskin & Sears also knew, or was reckless in not knowing, that the tax opinions it prepared were false and misleading since the represented tax deductions could not be achieved because the minimum annual royalties to be paid by the partnerships to TexOil were payable largely in long-term non-recourse notes, which did not satisfy applicable Treasury Regulations in order to be deductible, which fact was also known to, or recklessly disregarded by, Baskin & Sears at the time it rendered its tax opinions.

(b) Baskin and Sears also substantially assisted and thus aided and abetted the fraud herein alleged. The firm provided tax assistance letters to the partnerships in which it agreed to defend the partnerships in the event of an IRS challenge to the tax structure set forth in the confidential memoranda, which letters were included in such memoranda, as hereinabove specified. Baskin & Sears knew that its tax assistance letters were

materially misleading because it knew that the represented tax deductions could not be achieved because, *inter alia*, it knew that Elektra Energy was the agent of the partnerships, Heim, Savery, the Petrotec Entities over which they exercised control, including Elektra Energy, directed the operations of the partnerships, including the terms of all partnership contracts and the identity of partnership consultants, and because the license fees paid by the partnerships to Elektra Energy were not "ordinary and necessary" business expenses nor "research and development" expenditures. Baskin & Sears also knew that the minimum annual royalties to be paid by the partnerships were payable largely in long-term non-recourse notes, which did not satisfy applicable Treasury Regulations in order to be deductible, which fact was also known to Baskin & Sears at the time it rendered its tax assistance letters.

70. Friedman & Shaftan, P.C. was a principal and an aider and abettor in connection with the foregoing alleged plan, concerted scheme, conspiracy, and common course of conduct.

(a) Friedman & Shaftan was a principal in that it knowingly or recklessly rendered false and misleading tax opinions, as hereinabove specified. In preparing tax opinions for the Manhattan Partnerships, Friedman & Shaftan was charged by law to investigate the statements made in the confidential memoranda for such partnerships and could not rely solely on the representations of management as to the business plan and operations of the partnerships. As a result, Friedman & Shaftan knew, or was reckless in not knowing, that its tax opinions were false and misleading since, *inter alia*, the represented tax deductions could not be achieved because (i) Elektra Oil was the agent of the partnerships, (ii) Heim, Savery, the Petrotec Entities over which they exercised control, including Elektra Oil, directed the operations of the partnerships, including the terms of all partnership contracts and the identity of partnership consultants, and (iii) the license fees paid by the partnerships to Elektra Oil were not "ordinary and necessary" expenses nor "research and development expenditures," all of which facts were known to, or recklessly disregarded by, Friedman & Shaftan at the time it rendered its tax opinions. Friedman & Shaftan also knew, or

was reckless in not knowing, that the tax opinions it prepared were false and misleading since the represented tax deductions could not be achieved because the minimum annual royalties to be paid by the partnerships to TexOil were payable largely in long-term non-recourse notes, which did not satisfy applicable Treasury Regulations in order to be deductible, which fact was also known to, or recklessly disregarded by, Friedman & Shaftan at the time it rendered its tax opinions.

(b) Friedman & Shaftan also substantially assisted and thus aided and abetted the fraud herein alleged. The firm provided tax assistance letters to the partnerships in which it agreed to defend the partnerships in the event of an IRS challenge to the tax structure set forth in the confidential memoranda, which letters were included in such memoranda as hereinabove specified. Friedman & Shaftan knew that its tax assistance letters were materially misleading because it knew that the represented tax deductions could not be achieved because, *inter alia*, it knew that Elektra Oil and Elektra Energy were the agents of the partnerships, Heim, Savery, the Petrotec Entities over which they exercised control, including Elektra Oil and Elektra Energy, directed the operations of the partnerships, including the terms of all partnership contracts and the identity of partnership consultants, and because the license fees paid by the partnerships to Elektra Oil and Elektra Energy were not "ordinary and necessary" business expenses nor "research and development" expenditures. Friedman & Shaftan also knew that the minimum annual royalties to be paid by the partnerships were payable largely in long-term non-recourse notes, which did not satisfy applicable Treasury Regulations in order to be deductible, which fact was also known to Friedman & Shaftan at the time it rendered its tax assistance letters.

71. Schumacher & Hickey was a principal and an aider and abettor in connection with the foregoing alleged plan, concerted scheme, conspiracy and common course of conduct.

(a) Schumacher & Hickey was a principal in that it knowingly or recklessly rendered false and misleading tax opinions, as hereinabove specified. In preparing tax opinions for the

Wichita Partnerships, Schumacher & Hickey was charged by law to investigate the statements made in the confidential memoranda for such partnerships and could not rely solely on the representations of management as to the business plan and operations of the partnerships. As a result, Schumacher & Hickey knew, or was reckless in not knowing, that its tax opinions were false and misleading since, *inter alia*, the represented tax deductions could not be achieved because (i) Hemisphere was the agent of the partnerships, (ii) Heim, Savery, the Petrotec Entities over which they exercised control, including Hemisphere, directed the operations of the partnerships, including the terms of all partnership contracts and the identity of partnership consultants, and (iii) the license fees paid by the partnerships to Hemisphere were not "ordinary and necessary" business expenses nor "research and development expenditures," all of which facts were known to, or recklessly disregarded by Schumacher & Hickey at the time it rendered its tax opinions.

(b) Schumacher & Hickey also substantially assisted and thus aided and abetted the fraud herein alleged. The firm provided tax assistance letters to the partnerships in which it agreed to defend the partnerships in the event of an IRS challenge to the tax structure set forth in the confidential memoranda, which letters were included in such memoranda as hereinabove specified. Schumacher & Hickey knew that its tax assistance letters were materially misleading because it knew that the represented deductions could not be achieved because, *inter alia*, it knew that Hemisphere was the agent of the partnerships, Heim, Savery, the Petrotec Entities over which they exercised control, including Hemisphere, directed the operations of the partnerships, including the terms of all partnership contracts, and the identity of partnership consultants, and because the license fees paid by the partnerships to Hemisphere were not "ordinary and necessary" business expenses nor "research and development" expenditures.

72. Frederick R. Schumacher, Ltd., A Professional Law Corporation, was a principal and an aider and abettor in con-

nection with the foregoing alleged plan, concerted scheme, conspiracy and common course of conduct.

(a) Frederick R. Schumacher, Ltd., was a principal in that it knowingly or recklessly rendered false and misleading tax opinions, as hereinabove specified. In preparing tax opinions for the Wichita Partnerships, Frederick R. Schumacher, Ltd., was charged by law to investigate the statements made in the confidential memoranda for such partnerships and could not rely solely on the representations of management as to the business plan and operations of the partnerships. As a result, Frederick R. Schumacher, Ltd., knew, or was reckless in not knowing, that its tax opinions were false and misleading since, *inter alia*, the represented tax deductions could not be achieved because (i) Hemisphere was the agent of the partnerships, (ii) Heim, Savery, the Petrotec Entities over which they exercised control, including Hemisphere, directed the operations of the partnerships, including the terms of all partnership contracts and the identity of partnership consultants, and (iii) the license fees paid by the partnerships to Hemisphere were not "ordinary and necessary" business expenses nor "research and development expenditures," all of which facts were known to, or recklessly disregarded by Frederick R. Schumacher, Ltd., at the time it rendered its tax opinions.

(b) Frederick R. Schumacher, Ltd., also substantially assisted and thus aided and abetted the fraud herein alleged. The firm provided tax assistance letters to the partnerships in which it agreed to defend the partnerships in the event of an IRS challenge to the tax structure set forth in the confidential memoranda, which letters were included in such memoranda as hereinabove specified. Frederick R. Schumacher, Ltd., knew that its tax assistance letters were materially misleading because it knew that the represented deductions could not be achieved because, *inter alia*, it knew that Hemisphere was the agent of the partnerships, Heim, Savery, the Petrotec Entities over which they exercised control, including Hemisphere, directed the operations of the partnerships, including the terms of all partnership contracts, and the identity of partnership consultants, and because the license fees paid by the partnerships to

Hemisphere were not "ordinary and necessary" business expenses nor "research and development" expenditures.

73. Houston Harbaugh was a principal in connection with the foregoing alleged plan, concerted scheme, conspiracy and common course of conduct in that it issued false and misleading title opinions, as hereinabove specified. In preparing title opinions for the Denver and Wichita Partnerships, Houston Harbaugh was charged by law to investigate the statements made in the confidential memoranda for said partnerships and could not rely solely on the representations of management as to the business plan and operations of the partnerships. As a result, Houston Harbaugh knew, or was reckless in not knowing, that its title opinions were false and misleading in the respects specified in paragraph 42 above. Among other things, Houston Harbaugh, at or about the time it issued said opinions, represented defendants Tulsebond and Tamaro Holding, including acting as counsel thereto, in litigation brought in Pennsylvania state court by a third party respecting rights to the Parker Field properties. In that litigation, it was alleged that Heim was the beneficial owner of Tulsebond and Tamaro Holding. Houston Harbaugh was thereby put on notice of Heim's interests in said entities and therefore knew, or recklessly disregarded that fact, for it did not disclose it in its title opinions, even though said fact was material to investors. Moreoever, in its title opinions, Houston Harbaugh opined that various transfers of the property to be acquired by the partnerships had occurred between Finagest, Tamaro Holding and Tulsebond, but not only failed to disclose that Heim controlled all three of these entities but that he was also a promoter of the partnerships and that the properties would be sold to the partnerships at grossly inflated prices.

74. By reason of the aforesaid conduct, the defendants, and each of them, violated Section 10(b) of the Exchange Act and Rule 10b-5 thereunder. As a direct and proximate result of the aforesaid conduct, plaintiffs and the members of the class suffered substantial damages in connection with their purchases of interests in the Oil Technology Group Partnerships.

SECOND CLAIM

CONSPIRACY TO VIOLATE SECTION 10(b) OF THE EXCHANGE ACT AND RULE 10b-5 THEREUNDER

75. Plaintiffs reallege and incorporate herein by this reference each and every allegation contained in paragraphs 1 through 48 and 51-73.

76. This Second Claim is brought by plaintiffs, on behalf of themselves and the members of the class, against all defendants, each of whom knowingly and willfully joined together in a conspiracy to defraud purchasers of interests in the Oil Technology Group Partnerships in violation of Section 10(b) of the Exchange Act and Rule 10b-5 thereunder. Said conspiracy was carried out knowingly and intentionally by each of the defendants with the sole intent to benefit themselves and each of them, at the expense of plaintiffs and the members of the plaintiff class.

77. The idea for the conspiracy was conceived sometime in 1978 or 1979, the exact dates being unknown to plaintiffs but which information is within the knowledge of defendants Heim, Savery, and other of the defendants. At that time, defendant Savery was employed in the securities industry by Shearson Loeb Rhoades, Inc. and was located at a Shearson office somewhere in Europe, the identity of which is unknown to plaintiffs but known to defendant Savery. In or about this time period, Savery met with defendants Heim and Hilpert, residents of Switzerland, who served as the chairman and chief executive officer of defendant Petrotec, respectively. Petrotec was purportedly engaged in the technology transfer business. Heim, in his capacity as an officer of Petrotec, also had previously worked with the Swiss Federal Institute of Technology, where he had come to know of the work of defendant Armin Fiechter, a microbiologist, and defendant Erich Puhar, a chemical engineer. The details of the time and place of the initial meeting or meetings between Heim, Hilpert and Savery in regards to the conspiracy herein alleged are unknown to plaintiffs but are known to these defendants.

78. At the time of this initial meeting or meetings, the price of crude oil had reached record or near record levels, thereby encouraging the drilling for, and exploration of, previously undeveloped sources of oil, including the use of experimental enhanced oil recovery technologies to further develop known oil deposits. Given these existing economic conditions in the oil industry, Heim, Hilpert and Savery concluded that substantial sums of money could be garnered through the sale, leasing or marketing of EOR technologies purportedly developed or possessed by Petrotec and Swiss scientists associated therewith. Pursuant to this plan, Savery returned to the United States sometime during 1978 or 1979, the exact dates being unknown to plaintiffs but known to Savery, for the express purpose of attempting to market such EOR technologies directly to major oil producers and developers. Savery's efforts in this regard, however, were unsuccessful due, in large measure, to the experimental and unproven nature of the technologies purportedly possessed by Petrotec.

79. Confronted with the inability to sell these EOR technologies to established oil concerns, Heim, Hilpert and Savery decided to embark on a different strategy, namely the creation of the Oil Technology Group Partnerships. In so doing, these defendants formed the conspiracy alleged herein, the purpose and effect of which was to induce plaintiffs and the members of the plaintiff class to purchase interests in the Oil Technology Group Partnerships. Despite knowing, in light of their previous marketing efforts, that the technologies purportedly possessed by Petrotec were non-existent, untested and/or unproven and for which no market existed, Heim, Hilpert and Savery nonetheless concluded that substantial sums of money could be raised from investors by structuring tax-oriented limited partnerships on the basis of false representations that certain extremely favorable tax benefits would be available by virtue of this investment and that substantial future economic potential existed as a result of the EOR technologies to be transferred to the partnerships. As a first step in furtherance of the conspiracy, Savery caused to be incorporated defendant Elektra Oil Corporation as a domestic subsidiary of Mardyn, N.V., a Neth-

erlands Antilles corporation, to license the EOR technologies. At or about the same time, Heim, Hilpert and Savery procured the agreement of Fiechter and Puhar to provide expert consulting services to Elektra Oil in connection with the planned EOR operations. Given their expertise in the field of EOR technology, Fiechter and Puhar knew when they agreed to provide such services that the EOR technologies that Heim, Hilpert and Savery intended to market were grossly overvalued. By agreeing to provide such services Fiechter and Puhar joined the conspiracy and actively participated therein.

80. In connection with the formulation of the business plan of the partnerships, Heim, Hilpert and Savery also reached agreement among themselves on the license fees that Elektra Oil would charge the partnerships for use of the purported EOR technology. Due to the anticipated millions of dollars that would be paid by limited partners and, in turn, delivered to Elektra Oil and, later, Elektra Energy and Hemisphere, Heim, with the knowledge and agreement of Savery, undertook to form numerous additional entities under the laws of foreign jurisdictions to which the license fees payable by the partnerships would be transferred. The purpose in creating these various entities was to gain access to the huge sums of monies to be deposited by investors, conceal the fraud herein alleged and render it extremely difficult to trace the monies paid by investors. The entities formed by Heim in this connection include defendants Petrotec Lugano, A.G.; the PAX-Innovations Foundation; Columbus Valley, N.V.; Mardyn, N.V.; Nelantex; Narod, N.V.; Tulsebond, Ltd.; Shalelectric, S.A.; Finagest, A.G.; and Tamaro Holding, Inc.

81. In furtherance of the conspiracy, Savery also began, in 1979, to search for potential candidates to act as general partners of the Oil Technology Group Partnerships. In that connection, Savery's extensive background and contacts in the securities industry led him to two individuals, Richard B. Basile and Louis F. Coppage. Initially, Savery secured the agreement of Basile and Coppage to act as individual general partners in eight (8) partnerships which were planned to be marketed in 1979, *i.e.*, the 1979 Denver and Manhattan Partnerships. At

that time, neither Coppage nor Basile had any previous experience in the oil and gas industry, but both nonetheless knowingly joined the conspiracy in return for promises of earning substantial sums of money for agreeing to act as general partners. By agreeing to act as general partners and thereafter so acting, Basile and Coppage were active participants in the conspiracy. The dates and details of the meetings by which the agreements between Savery, Basile and Coppage were reached, as well as the specific terms of the agreements themselves, are unknown to plaintiffs but are within the knowledge of these defendants.

82. In furtherance of the conspiracy, Savery also secured the agreement of defendant Glenda Exploration and Development Corporation ("GEDCO") of Monroe, Louisiana in 1979 to serve as corporate general partner for the 1979 partnerships and thus to participate in the conspiracy herein alleged. The dates and details of the agreement reached between Savery and GEDCO are unknown to plaintiffs but are known by these defendants. As part of such agreement, Savery, Basile and GEDCO agreed that gas drilling operations on the Monroe Field would become part of the business plan of the partnerships even though GEDCO knew the wells were unlikely to produce gas profitably. By agreeing to act as general partner and by failing to disclose the fraud herein alleged, GEDCO was an active participant in the conspiracy.

83. Because the conspiracy conceived of by Heim, Hilpert and Savery envisioned the sale of tax-oriented limited partnership interests for which, apart from the larger market for tax oriented investments, no established market then existed, a critical step in furtherance of the conspiracy was locating professionals willing to lend their names and expertise to the venture so as to provide credibility to the investment. In that connection, once the 1979 partnerships had been legally formed, the general partners, *i.e.*, Coppage, Basile and GEDCO, successfully sought out, located and solicited the services of the following law firms, accountants and consultants who were willing to lend their expertise to the partnerships and to provide tax opinions, projections, and audit reports in return for substantial fees.

(a) In 1979, and on behalf of the partnerships for which he served as general partner, Basile retained the New York law firm of Friedman & Shaftan, P.C. to render tax opinions for the 1979 Manhattan Partnerships. The dates and terms of the meetings leading up to the agreement between Friedman & Shaftan and Basile, as well as the specific terms of the agreement itself, are unknown to plaintiffs but are within the knowledge of these defendants. Once the agreement of Friedman & Shaftan, P.C. to render such opinions was reached, the firm thereafter joined the conspiracy and became an active participant therein by rendering tax opinions for inclusion in confidential memoranda, which opinions were false and misleading, as hereinabove alleged, and which opinions were known by Friedman & Shaftan to lend credibility to the investment and be relied upon by investors in making their investment decisions.

(b) In 1979, Basile also retained Elmer, Fox, Westheimer & Company (now known as Fox & Company) to provide accounting services for the 1979 Manhattan Partnerships. The dates and terms of the meetings leading up to the agreement between Fox and Basile, as well as the specific terms of the agreement itself, are unknown to plaintiffs but are within the knowledge of these defendants. Once the agreement of Fox to provide such services was reached, Fox thereafter knowingly joined and became an active participant in the conspiracy by rendering tax opinions, estimated federal tax saving projections and reports on financial statements, all of which materials were false and misleading, as hereinabove alleged, and all of which materials were known by Fox to lend credibility to the investment and be relied on by investors in making their investment decisions.

(c) In 1979, Basile, Coppage, and Savery, on behalf of the partnerships, met and thereafter contracted with defendant CLD Group, Inc. to provide a report on the best available acreage for the partnerships' EOR operations. The dates and details of the meetings leading up to the agreement between CLD Group and Basile, Coppage and Savery, as well as the specific terms of the agreement itself, are unknown to plaintiffs but are within the knowledge of these defendants. As hereinabove alleged, CLD Group, Inc. consisted of defendants Lewin and

Associates, Inc., whose vice-president and chief financial officer at that time, Vello Kuuskraa, signed the opinion of CLD Group, Inc. included in the confidential memoranda, The Doscher Group, Inc., whose president was defendant Todd Michael Doscher, and defendant Case Engineering and Laboratory, Inc. As a result of the foregoing agreement, each of these defendants, all major stockholders in CLD Group, Inc., knowingly joined the conspiracy and became active participants therein by providing the opinion on partnership properties, which opinion was false and misleading, as hereinabove alleged, and which opinion was known by these defendants to lend credibility to the investment and be relied on by investors in making their investment decisions.

(d) From 1979, Doscher continued to render consulting services to the Oil Technology Group Partnerships through completion of the partnerships' syndication, and throughout that period reached various agreements with, among others, Savery and Elektra, to provide such services. The dates and details of the meetings leading up to the agreements Doscher entered into, as well as the specific terms of the agreements themselves, are unknown to plaintiffs but are within the knowledge of these defendants. As a result of the foregoing agreements, Doscher knowingly joined the conspiracy and became an active participant therein by providing consulting services, and consenting to the use of his name in the confidential memoranda, which lent credibility to the investment and was relied on by investors in making their investment decisions.

84. Following the successful syndication of the eight partnerships in 1979 hereinabove identified, syndication of the Manhattan Partnerships continued in 1980 with the formation and marketing of interests in fourteen (14) additional partnerships. At that time, Heim and Savery also agreed to change the name of the technology licensor from Elektra Oil Corporation to Elektra Energy Corporation. In addition, the general partners, Basile and GEDCO, successfully solicited the services of several additional firms and individuals to lend their expertise to the partnerships in return for substantial fees.

(a) In 1980, and on behalf of the partnerships for which he served as general partner, Basile retained the law firm of Baskin & Sears to render tax opinions for the 1980 Manhattan Partnerships. The dates and details of the meetings leading up to the agreement between Baskin & Sears and Basile, as well as the specific terms of the agreement itself, are unknown to plaintiffs but are within the knowledge of these defendants. Once the agreement of Baskin & Sears to render such opinions was reached, the firm thereafter joined the conspiracy and became an active participant therein by rendering tax opinions for inclusion in the confidential memoranda which opinions were false and misleading, as hereinabove alleged, and which opinions were known by Baskin & Sears to lend credibility to the investment and be relied on by investors in making their investment decisions.

(b) In 1980, Friedman & Shaftan continued to actively participate in the conspiracy by agreeing to provide Basile, on behalf of certain of the Manhattan Partnerships, with tax assistance letters for inclusion in certain of the confidential memoranda for the 1980 Manhattan Partnerships, whereby Freidman & Shaftan agreed to defend tax deductions claimed by investors in the partnerships in the event of an IRS challenge thereto.

(c) In 1980, Savery contracted with defendant Neil E. Rogen whereby Rogen agreed to become an EOR consultant to the partnerships and to serve as president of Elektra Energy Corporation. The dates and details of the meetings leading up to the agreement between Savery and Rogen, as well as the specific terms of the agreement itself, are unknown to plaintiffs but are within the knowledge of these defendants. As hereinabove alleged, Rogen agreed to allow the use of his name in the confidential memoranda and undertook to carry out Elektra's business, including corresponding with the general partners regarding the status of partnership operations, collecting license fees from the partnerships and negotiating the terms of contracts with other EOR consultants Elektra sought to retain. Notwithstanding his knowledge of the fraud, as hereinabove alleged, Rogen continued to render such services to the partnerships and the licensors through 1984 yet, during said time,

failed to advise investors of the omissions and misrepresentations of material fact in the confidential memoranda. Rogen therefore actively participated in the conspiracy.

(d) In 1980, Savery contracted wtih defendant William R. Conklin whereby Conklin agreed to serve as an officer of Elektra Energy and as the escrow agent for collection of license fees. Conklin also agreed to act as Heim's agent for the purpose of conducting the business of the Petrotec Entities in the United States. The dates and details of the meetings leading up to the agreements beween Savery and Conklin, as well as the specific terms of the agreements themselves, are unknown to plaintiffs but are within the knowledge of these defendants. As a result of the foregoing agreements, Conklin knowingly joined the conspiracy and became an active participant therein by providing services to Heim, Savery and the Petrotec Entities, and carrying out the affairs of said entities.

85. On or about May 15, 1980, Basile, on behalf of the Manhattan Partnerships, contracted with defendant Lewin Energy Corporation to replace CLD Group, Inc. as the consulting firm that would provide an opinion on the best available acreage for the partnership's EOR operations. The dates and details of the meetings leading up to the agreement between Basile and Lewin Energy, as well as the specific terms of the agreement itself, are unknown to plaintiffs but are within the knowledge of these defendants. Defendant Kuuskraa, an officer and director of Lewin Energy, who, as an officer of Lewin and Associates, had signed CLD Group's opinion for the 1979 partnerships, continued to sign the opinions on behalf of Lewin Energy that were included in the confidential memoranda, as hereinabove specified. Once the agreement of Lewin Energy to render such opinions was reached, Lewin Energy thereafter joined the conspiracy and became an active participant therein by providing the opinion on partnership properties for inclusion in the confidential memoranda, which opinions were false and misleading, as hereinabove alleged, and which opinions were known by Lewin Energy to lend credibility to the investment and be relied on by investors in making their investment decisions.

86. In September 1980, in anticipation of syndicating additional partnerships in 1981 and 1982, Heim and Savery caused to be incorporated Hemisphere Licensing Corporation. Hemisphere, like Elektra Oil and Elektra Energy, was a subsidiary of Petrotec Systems, A.G. At the time of this change in the name of the technology licensor, defendant Rogen agreed to serve as president of Hemisphere with knowledge that Hemisphere was to serve the same function as Elektra Energy, *i.e.*, to siphon off investor money in the form of bogus license fees. Heim, Savery and Rogen also caused to be incorporated Petroleum Sciences, Inc., which was to serve as a subsidiary of Hemisphere for the purpose of purportedly providing consulting services to the partnerships respecting the design and operation of EOR facilities. Rogen was installed as president of Petroleum Sciences.

87. In order to complete the syndication of the Denver Partnerships in 1981, sometime in late 1980 or early 1981, the exact dates being unknown to plaintiffs but within the knowledge of these defendants, Savery and defendant Coppage agreed that Coppage would serve as individual general partner for the 1981 partnerships and further secured Coppage's agreement to use his company, American Energy Resources, Inc., as corporate general partner. Coppage thereafter sought out, located and solicited the services of the following law firms and accountants who were willing to lend their expertise to the partnerships and to provide tax opinions, audit reports, geologic and financial analysis reports, and an evaluation of Hemisphere's technology portfolio.

(a) With regard to accounting services for the 1981 and 1982 Denver Partnerships, Coppage turned to a longstanding personal friend, Harold E. Williamson, the partner in charge of Peat's Denver office, where AER's principal office was also then located. Sometime in 1981, the exact dates being unknown to plaintiffs but within the knowledge of these defendants, Williamson, on behalf of Peat, reached an agreement with Coppage whereby Peat agreed to serve as the partnerships' auditors and to render tax return preparation services in return for the payment of substantial fees. Once the agreement to provide such services was reached, Peat thereafter actively participated

in the conspiracy by consenting to the use of its name in the confidential memoranda, as hereinabove alleged, and by rendering reports on the partnerships' financial statements and issuing tax returns, which reports and returns were false and misleading, as hereinabove alleged, and known by Peat to lend credibility to the investment and be relied on by investors in making their investment decisions.

(b) In connection with syndication of the 1981-1982 partnerships, Coppage and Savery also determined that a title opinion, showing that the partnerships had legally acquired interests in the Parker Field properties, was required in order to lend further credibility to the offering and to conceal Heim's interest in the properties to be transferred to the partnerships as well as the fact that the prices paid by the partnerships for the properties were excessive. Thus, in furtherance of this aspect of the conspiracy, Coppage, sometime in 1981, the exact dates being unknown to plaintiffs but within the knowledge of these defendants, retained the law firm of Houston Harbaugh to render the requisite title opinion. The dates and details of the meetings leading up to the agreement between Houston Harbaugh and Coppage, as well as the specific terms of the agreement itself, are unknown to plaintiffs but are within the knowledge of these defendants. Once the agreement to provide such opinions was reached, Houston Harbaugh thereafter knowingly joined and became an active participant in the conspiracy by rendering opinions, which, as hereinabove alleged, were false and misleading in that they represented that title to the properties was vested in Tulsebond while failing to disclose that Heim owned Tulsebond and was also a promoter of the partnerships, which opinions were known by Houston Harbaugh to lend credibility to the investment and be relied on by investors in making their investment decisions. In connection with preparation of said title opinions, Houston Harbaugh received direction from defendants Robert E. Altenbach and Savery respecting the disclosures to be made therein.

(c) The Denver Partnerships syndicated in 1981 and 1982 also required an opinion on the portfolio of EOR technologies Hemisphere offered for license. In that connection, sometime

in late 1980 or early 1981, the exact dates being unknown to plaintiffs but within the knowledge of these defendants, Savery, who was a close personal friend of R. L. DiCicco, president of Technology Catalysts, contracted with Technology Catalysts to provide such opinions. The dates and details of the meeting leading up to the agreement between Technology Catalysts and Savery, as well as the specific terms of the agreement itself, are unknown to plaintiffs but are within the knowledge of these defendants. Once the agreement to render such opinions was reached, Technology Catalysts thereafter joined the conspiracy and became an active participant therein by rendering said opinions on the uniqueness and value of the EOR technologies available for license from Hemisphere for inclusion in the confidential memoranda, which opinions were false and misleading, as hereinabove alleged, and which opinions were known by Technology Catalysts to lend credibility to the investment and be relied on by investors in making their investment decisions.

(d) In late 1980 or early 1981, on behalf of the partnerships for which he served as general partner, Coppage retained the law firm of Somers & Altenbach to render tax opinions, provide tax assistance letters, and render other securities advice to Coppage, American Energy Resources, Inc. and the Denver Partnerships. The dates and details of the meetings leading up to the agreement between Somers & Altenbach, through one of its members, defendant Robert E. Altenbach, and Coppage, as well as the specific terms of the agreement itself, are unknown to plaintiffs but are within the knowledge of these defendants. Once the agreement of Somers & Altenbach to render such opinions was reached, the firm thereafter joined the conspiracy and became an active participant therein by rendering tax opinions for inclusion in the confidential memoranda, which opinions were false and misleading, as hereinabove alleged, and which opinions were known by Somers & Altenbach to lend credibility to the investment and be relied on by investors in making their investment decisions.

(e) In 1981, the exact dates being unknown to plaintiffs but within the knowledge of these defendants, Coppage contracted with defendants Greg Bogdan, James A. Cunningham, Robert

LaGuardia and Darrel McCullough to run the day-to-day business affairs of American Energy Resources, Inc., AER Investments, Inc., the Foresee Group, Ltd. and the partnerships. The dates and details of the meetings leading up to the agreements between these defendants, as well as the specific terms of the agreements themselves, are unknown to plaintiffs but are within the knowledge of these defendants. Once these agreements had been reached, these individuals thereafter joined the conspiracy and became active participants therein by carrying out the affairs of said entities, and thus lending the appearance of credibility to the partnerships' operations.

(f) One of the attorneys who was employed by Somers & Altenbach in 1981 and 1982, defendant T. Kenneth Pyles, was hired by Coppage to serve as president of AER in 1983, the exact dates and terms of said agreement being unknown to plaintiffs but which are within the knowledge of these defendants. Once this agreement had been reached, Pyles thereafter joined the conspiracy and became an active participant therein by working with defendants Coppage, Bogdan, LaGuardia, Cunningham and McCullough in running AER's day-to-day business, and thus lending the appearance of credibility to the partnerships' operations.

88. In order to complete the syndication of a third group of partnerships in 1981-1982, Savery reached agreement sometime in 1980, the exact dates and terms of which are unknown to plaintiffs but within the knowledge of these defendants, with defendant Gary E. Krause. Krause agreed to act as individual general partner in nine (9) partnerships which were planned to be marketed in 1981 and 1982, *i.e.*, the Wichita Partnerships. As part of that agreement, Krause also committed to forming a corporation, Energy Associates, Inc., to serve as the corporate general partner for the Wichita Partnerships. As a result of this agreement, Krause and Energy Associates knowingly joined the conspiracy, and were active participants therein, in return for promises of earning substantial sums of money as a result thereof.

89. Once the Wichita Partnerships had been legally formed, Krause successfully solicited the services of the following law firms, accountants and consultants who were willing to lend their expertise to the partnerships and to provide tax opinions, title opinions, projections and audit reports in return for substantial fees.

(a) In 1981, and on behalf of the partnerships for which he served as general partner, Krause retained the law firm of Schumacher & Hickey to render tax opinions for the 1981 Wichita Partnerships. Krause was introduced to Frederick R. Schumacher, a partner in Schumacher & Hickey, through Coppage, who had previously utilized Schumacher's services when he was a member of the New York firm of Hartke, Hickey, Schumacher & Smith for a tax opinion for Cromwell Oil and Gas Associates, 1979, in which Coppage served as general partner. The dates and details of the meetings leading up to the agreement between Schumacher & Hickey and Krause, as well as the specific agreement itself, are unknown to plaintiffs but are within the knowledge of these defendants. Once the agreement of Schumacher & Hickey to render such opinions was reached, the firm thereafter joined the conspiracy and became an active participant therein by rendering tax opinions for inclusion in the confidential memoranda, which opinions were false and misleading, as hereinabove alleged, and which opinions were known by Schumacher & Hickey to lend credibility to the investment and be relied on by investors in making their investment decisions.

(b) In 1982, the exact date being unknown to plaintiffs but within the knowledge of these defendants, Krause retained Frederick R. Schumacher, Ltd., A Professional Law Corporation, the successor firm to Schumacher & Hickey, to render tax opinions for the 1982 Wichita Partnerships. The dates and details of the meetings leading up to the agreement between Frederick R. Schumacher, Ltd. and Krause, as well as the specific terms of the agreement itself, are unknown to plaintiffs but are within the knowledge of these defendants. Once the agreement of Frederick R. Schumacher, Ltd. to render such opinions was reached, the firm thereafter joined the conspiracy

and became an active participant therein by rendering tax opinions for inclusion in the confidential memoranda, which opinions were false and misleading, as hereinabove alleged, and which opinions were known by Frederick R. Schumacher, Ltd. to lend credibility to the investment and be relied on by investors in making their investment decisions.

(c) Sometime in 1981, the exact dates being unknown to plaintiffs but within the knowledge of these defendants, Krause retained the law firm of Houston Harbaugh to render title opinions to the Wichita Partnerships. The dates and details of the meetings leading up to the agreement reached between Houston Harbaugh and Krause, as well as the specific terms of the agreement itself, are unknown to plaintiffs but are within the knowledge of these defendants. Houston Harbaugh had also contracted in or around the same time with Coppage to render title opinions to the Denver Partnerships. The opinions provided to the Wichita Partnerships were false and misleading as hereinabove alleged, and were virtually identical to the opinions included in the confidential memoranda for the 1981 and 1982 Denver Partnerships. Thus, by virtue of its agreement with Krause, Houston Harbaugh continued to actively participate in the conspiracy herein alleged.

(d) Sometime in 1981, the exact dates being unknown to plaintiffs but within the knowledge of these defendants, Krause retained Lewin Energy Corporation to render geologic and financial analysis reports to the Wichita Partnerships. The dates and details of the meetings leading up to the agreement between Lewin Energy and Krause, as well as the specific terms of the agreement itself, are unknown to plaintiffs but are within the knowledge of these defendants. Lewin Energy had also contracted in or around the same time with Coppage to render geologic and financial analysis reports to the Denver Partnerships. The opinions provided to the Wichita Partnerships were false and misleading, as hereinabove alleged, and virtually identical to the opinions included in the confidential memoranda for the 1981 and 1982 Denver Partnerships. Thus, by virtue of its agreement with Krause, Lewin Energy continued to actively participate in the conspiracy herein alleged.

(e) Sometime in 1981, the exact dates being unknown to plaintiffs but within the knowledge of these defendants, Krause retained Fox & Company to provide accounting services to the 1981 and 1982 Wichita Partnerships. The dates and details of the meetings leading up to the agreement between Fox & Company and Krause, as well as the specific terms of the agreement itself, are unknown to plaintiffs but are within the knowledge of these defendants. Fox had previously contracted with defendant Basile to provide accounting services to the 1979 and 1980 Manhattan Partnerships. Thus, by virtue of its agreement with Krause, Fox continued to actively participate in the conspiracy herein alleged.

(f) Sometime in 1981, the exact dates being unknown to plaintiffs, but within the knowledge of these defendants, defendant DiCicco, on behalf of Technology Catalysts, and Savery reached an agreement whereby Technology Catalysts would provide the Wichita Partnerships an opinion on the uniqueness and value of the EOR technologies available for license from Hemisphere for inclusion in the confidential memoranda. The dates and details of the meeting leading up to the agreement between Savery and Technology Catalysts, as well as the specific terms of the agreement itself, are unknown to plaintiffs but are within the knowledge of these defendants. The opinions provided to the Wichita Partnerships were false and misleading, as hereinabove alleged, and virtually identical to the opinions included in the confidential memoranda for the 1981 and 1982 Denver Partnerships. Thus, by virtue of its agreement with Savery to provide such opinions to the Wichita Partnerships, Technology Catalysts and DiCicco continued to actively participate in the conspiracy herein alleged.

90. Sometime in 1980 or 1981, the exact dates being unknown to plaintiffs but within the knowledge of these defendants, Krause contracted with defendant C. Norris Taylor, Jr. to serve as vice president, secretary and a director of Energy Associates. The dates and details of the meetings leading up to the agreement between Taylor and Krause, as well as the specific terms of the agreement itself, are unknown to plaintiffs but are within the knowledge of these defendants. Once this

agreement had been reached, Taylor thereafter joined the conspiracy and became an active participant therein by helping to run the day-to-day business affairs of Energy Associates and thus lending the appearance of credibility to the partnerships' operations.

91. Pursuant to the conspiracy detailed above, the defendants collected approximately $200 million in cash from plaintiffs and the members of the class in connection with their purchases of interests in the Oil Technology Group Partnerships.

92. As a direct and proximate result of the foregoing conspiracy to defraud, plaintiffs and the members of the plaintiff class were damaged.

THIRD CLAIM

FOR VIOLATION OF SECTION 17(a) OF THE SECURITIES ACT

93. Plaintiffs reallege and incorporate herein by this reference each and every allegation contained in paragraphs 1-48, 51-73, and 77-91.

94. This Third Claim is based upon Section 17(a) of the Securities Act and is brought by plaintiffs, on behalf of themselves and the members of the class, against all defendants.

95. None of the false and misleading statements and omissions hereinabove alleged were known to plaintiffs and the members of the class at the time they made their purchases of interests in the Oil Technology Group Partnerships.

96. As a result of defendants' wrongful conduct, plaintiffs and the members of the class suffered substantial damage in connection with their purchases of interests in the Oil Technology Group Partnerships.

FOURTH CLAIM

FOR VIOLATION OF SECTION 12(2) OF THE SECURITIES ACT

97. Plaintiffs reallege and incorporate by this reference each and every allegation contained in paragraphs 1-48, 51-73, 77-91, and 95.

98. This Fourth Claim is based on Section 12(2) of the Securities Act and is asserted by plaintiffs, on behalf of themselves and the members of the class, against the Oil Technology Group Partnerships, Louis F. Coppage, Richard B. Basile, Gary E. Krause, GEDCO, AER, Energy Associates, Inc., the Petrotec Entities, Werner Heim, Max W. Hilpert, Winsor T. Savery, James A. Cunningham, Neil E. Rogen, Greg E. Bogdan, Darrel D. McCullough, T. Kenneth Pyles, Robert LaGuardia, William R. Conklin and C. Norris Taylor, Jr., all of whom sold, or substantially assisted the sale, of interests in the Oil Technology Group Partnerships.

99. Each of the defendants named in this Fourth Claim owed plaintiffs and the members of the class the duty to make reasonable and diligent investigation of the representations made in the confidential memoranda and other correspondence disseminated to investors to ensure that said representations were true and that there were no omissions to state material facts required to be stated in order to make the statements contained therein not misleading. Each of the defendants named in this Fourth Claim also owed such a duty to said purchasers with respect to the correspondence, financial statements and tax returns disseminated to investors subsequent to their initial purchases.

100. The Oil Technology Group Partnerships and each general partner thereof (*i.e.*, Louis F. Coppage, Richard B. Basile, Gary E. Krause, GEDCO, AER, and Energy Associates, Inc.), together with the Petrotec Entities and the officers and directors thereof, were the issuers and promoters of the Oil Technology Group Partnership securities. These entities and individuals organized the partnerships and determined the success or failure of their business and, therefore, were the issuers and pro-

moters of partnership interests. In addition, by virtue of their insider positions and access to relevant documentary material to which plaintiffs did not have access, the individual officers and directors of the Petrotec Entities were uniquely positioned to disclose the material inside information to which they alone had access in connection with plaintiffs' purchases of partnership interests. Plaintiffs and the members of the class relied on, or were impacted by, the confidential memoranda and other materials hereinabove described in making their investment decisions which documents were issued by the Oil Technology Group Partnerships, the general partners thereof, and the Petrotec Entities. Accordingly, these defendants were proximate causes and necessary and substantial factors in causing the sale transactions to take place.

101. None of the false and material omissions and misstatements made by defendants in connection with the offer and sale of interests in the partnerships were known to plaintiffs or the members of the class at the times they purchased interests in the partnerships.

102. By reason of the aforesaid conduct, the defendants identified in this Fourth Claim, and each of them, violated Section 12(2) of the Securities Act. As a direct and proximate result of defendants' wrongful conduct, as hereinabove alleged, plaintiffs and the members of the class suffered substantial damage in connection with their purchases of interests in the Oil Technology Group Partnerships. On behalf of the members of said class, plaintiffs hereby tender their limited partnership interests upon return of the consideration paid by them for said interests, plus interest thereon.

FIFTH CLAIM

FOR VIOLATION OF SECTION 12(1) OF THE SECURITIES ACT

103. Plaintiffs reallege and incorporate herein by this reference each and every allegation contained in paragraphs 1-48, 51-73, 77-91, and 99-101.

104. This Fifth Claim is based on Section 12(1) of the Securities Act and is asserted by plaintiffs, on behalf of themselves and the members of the class, against the Oil Technology Group Partnerships, Louis Coppage, Richard B. Basile, Gary E. Krause, GEDCO, AER, Energy Associates, Inc., the Petrotec Entities, Werner Heim, Max W. Hilpert, Winsor T. Savery, James A. Cunningham, Neil E. Rogen, Greg E. Bogdan, Darrel D. McCullough, T. Kenneth Pyles, Robert LaGuardia, William R. Conklin and C. Norris Taylor, Jr.

105. By reason of the aforesaid conduct, the defendants named in this Fifth Claim violated Section 12(1) of the Securities Act. As a direct and proximate result of the defendants' wrongful conduct, as hereinabove alleged, plaintiffs and the members of the class suffered substantial damage in connection with their purchases of interests in the Oil Technology Group Partnerships. On behalf of the members of said class, plaintiffs hereby tender their limited partnership interests upon return of the consideration paid by them for said interests, plus interest thereon.

SIXTH CLAIM

FOR VIOLATION OF SECTION 15 OF THE SECURITIES ACT

106. Plaintiffs reallege and incorporate herein by this reference each and every allegation contained in paragraphs 1-48, 51-73, 77-91, 94-96, 98-102, and 104-105.

107. This Sixth Claim is based on Section 15 of the Securities Act and is asserted by the plaintiffs, on behalf of themselves and the members of the plaintiff class, against the Petrotec Entities, Werner Heim, Winsor T. Savery, Louis F. Coppage, Richard B. Basile, Gary E. Krause, Neil E. Rogen, Max W. Hilpert, James A. Cunningham, T. Kenneth Pyles, Greg E. Bogdan, William Conklin, Darrel D. McCullough, Robert LaGuardia, and C. Norris Taylor, Jr.

108. Defendants Elektra Oil Corporation, Elektra Energy Corporation and Hemisphere Licensing Corporation, the pur-

ported technology licensors, as well as their parent corporation, defendant Petrotec Systems, A.G., controlled the operations of the Oil Technology Group Partnerships by virtue of their control over the general partners thereof. In addition, each of the remaining Petrotec Entities was controlled by Heim, Hilpert and Savery and thus directed the operations of the partnerships and the general partners thereof. Defendants Heim, Hilpert and Savery, who developed the idea for the formation of the partnerships, caused the incorporation of the technology licensors and ran their day-to-day business. The sole business of Elektra Oil, Elektra Energy and Hemisphere was to license purported EOR technologies to the partnerships and serve as the vehicles by which substantial sums of investor monies were misappropriated through the payment of license fees by the partnerships to the licensors. Defendant Savery, who served at various times as president of Elektra Oil, Elektra Energy and Hemisphere, directed the operations of the partnerships, including dictating the terms of the partnerships' contracts with the licensors, as well as the identity of partnership consultants.

109. As hereinabove alleged, defendants Heim, Hilpert, Savery, Coppage, Basile and Krause were members of the senior management of the Petrotec Entities and/or were general partners of the Oil Technology Group Partnerships. In addition, defendants Coppage, Basile and Krause were represented in the confidential memoranda for the Oil Technology Group Partnerships to constitute the management of the corporate general partners of the partnerships, with responsibility for carrying on the daily operations of the partnerships. Each of these defendants directly influenced the actions of the partnerships, including the syndication and operation of the Oil Technology Group Partnerships, directing the contents of the confidential memoranda for said partnerships, and failing to register the Oil Technology Group Partnership securities.

110. The Oil Technology Group Partnerships were managed by individual general partners, defendants Coppage, Basile and Krause, and by corporate general partners, Glenda Exploration and Development Corporation, American Energy Resources, Inc., and Energy Associates, Inc., the management of which

included defendants Heim and Savery who were members of the senior management of the Petrotec organization. Under the terms of the Oil Technology Group Partnership agreements and applicable law, the general partner of a partnership is a fiduciary of the partnership and the limited partners. The general partner must exercise good faith and integrity with respect to partnership affairs and must make full disclosure to the limited partners with respect to said affairs. The general partners of the Oil Technology Group Partnerships were charged by law with full and complete responsibility for the management of all affairs of the partnerships. Accordingly, defendants Heim, Hilpert and Savery, who acted as a member of senior management in the Petrotec Entities, the corporate general partners of the partnerships, American Energy Resources, Inc., Glenda Exploration and Development Corporation and Energy Associates, Inc., and the individual general partners had the power, directly or indirectly, to direct or cause the direction of the management of the Oil Technology Group Partnerships.

111. Defendant Neil E. Rogen served as president of Elektra Energy, Hemisphere and Petroleum Sciences, as hereinabove alleged. Rogen, together with Savery, managed the day-to-day affairs of these defendants, including meetings with the general partners, correspondence and accounting for the payment of all license fees. In addition, Rogen sought out and retained so-called EOR experts on behalf of defendants Elektra Energy and hemisphere, and negotiated the terms of the contracts between the licensors and the experts. Accordingly, Rogen directly influenced the actions of the technology licensors, including purportedly providing non-existent and/or ineffectual EOR technologies to the partnerships and collecting monies from the partnerships in the form of license fees pursuant to contracts which Rogen knew had not been negotiated at arm's length. Rogen agreed to and participated in the alleged plan, concerted scheme, conspiracy and common course of conduct, as hereinabove alleged, and, directly or indirectly, had the power to direct or cause the direction of the management and policies of the purported EOR technology licensors.

112. Defendants Cunningham. Pyles, Bogdan, Conklin, LaGuardia, McCullough and Taylor served as officers of either the corporate general partners or, for Conklin, the technology licensors, and in such positions carried out the day-to-day business affairs of said entities, including corresponding with investors, collecting investor money, preparing partnership progress reports for dissemination to investors and, with respect to defendant Conklin, collecting and distributing the license fees paid by the partnerships to the technology licensors. In addition, these defendants had access, by reason of occupying positions in the senior management of the Petrotec Entities, to the books and records of the partnerships and, as such, had effective control over their operations.

113. By reason of the aforesaid conduct, each of the defendants named in this claim, directly or indirectly, had the power to direct or cause the direction of the management and policies of the Oil Technology Group Partnerships. Accordingly, each such defendant is liable under Sections 12(1), 12(2) and 17(a) of the Securities Act by virtue of Section 15 thereof. As a direct and proximate result of defendants' aforesaid conduct, plaintiffs and the members of the class suffered substantial damage in connection with their purchases of interests in the Oil Technology Group Partnerships.

SEVENTH CLAIM

FOR VIOLATION OF SECTION 20 OF THE EXCHANGE ACT

114. Plaintiffs reallege and incorporate by this reference each and every allegation contained in paragraphs 1-48, 50-74, 76-92 and 108-112.

115. This Fifth Claim is based upon Section 20 of the Exchange Act and is asserted against the Petrotec Entities, Werner Heim, Winsor T. Savery, Louis F. Coppage, Richard B. Basile, Gary E. Krause, Neil E. Rogen, Max W. Hilpert, James A. Cunningham, T. Kenneth Pyles, Greg E. Bogdan,

William Conklin, Darrell D. McCullough, Robert LaGuardia and C. Norris Taylor, Jr.

116. By reason of the aforesaid conduct, each of the defendants named in this claim, directly or indirectly, had the power to direct or cause the direction of the management and policies of the Oil Technology Group Partnerships. Accordingly, each such defendant is liable under Section 10(b) of the Exchange Act and Rule 10b-5 promulgated thereunder, by virtue of Section 20(a) of the Exchange Act. As a direct and proximate result of the defendants' aforesaid wrongful conduct, plaintiff and the members of the class suffered substantial damage in connection with their purchases of interests in the Oil Technology Group Partnerships.

EIGHTH CLAIM

FOR NEGLIGENT MISREPRESENTATION AND RESPONDEAT SUPERIOR

117. Plaintiffs reallege and incorporate by this reference each and every allegation contained in paragraphs 1-48, 51-73, 77-91, 94-95, and 99-101.

118. This Eighth Claim is asserted by plaintiffs, on behalf of themselves and the members of the class, against all defendants, except Houston Harbaugh, and is based upon a pendent state law claim for negligent misrepresentation.

119. Each of the defendants named in this Eighth Claim made representations of fact and omitted to state material facts to plaintiffs and the members of the class by means of the confidential memoranda, financial statements and notes thereto, and tax returns, as specified hereinabove. Said misrepresentations were false and were made by defendants without reasonable grounds to believe they were true.

120. The representations and omissions to state material facts which give rise to this claim and the absence of reasonable grounds by defendants for believing in their truth, are set forth

in previous paragraphs of this complaint, which paragraphs are incorporated herein by reference as though fully set forth:

Defendant	*Paragraphs*
Oil Technology Group Partnerships	26, 34-37, 54
Heim	26, 34-37, 54, 55(g)
Fiechter	56(f)
Puhar	56(e)
Savery	26, 34-37, 54, 55(b)
Coppage	55(c)
Basile	55(d)
Krause	55(e)
Elektra Oil Corporation	54
Hemisphere Licensing Corporation	54
American Energy Resources, Inc.	54, 58
Glenda Exploration and Development Corporation	54, 57
Energy Resources, Inc.	54, 59
AER Investments, Inc.	54
The Foresee Group, Ltd.,	54
TexOil International Corporation	54, 67
Petroleum Sciences, Inc.,	54
Neil E. Rogen	55(f)
Lewin Energy Corporation	18(a), 46, 64
Lewin and Associates, Inc.	18(c), 65
Vello A. Kuuskraa	18(b), 45-46, 63-64
Technology Catalysts, Inc.	18(d), 47, 66
R. L. DiCicco	18(e), 47, 66
CLD Group, Inc.	18(g), 45, 63
The Doscher Group, Inc.	18(h), 45, 63
Todd Michael Doscher	18(f), 45, 55(h), 63
Case Engineering and Laboratory, Inc.	18(i), 45, 63
James A. Cunningham	55(k)

T. Kenneth Pyles	55(i)
Greg E. Bogdan	55(j)
Robert LaGuardia	56(b)
Darrel D. McCullough	56(c)
William R. Conklin	56(a0
C. Norris Taylor, Jr.	56(d)
Baskin & Sears	15(a), 41, 69
Friedman & Shaftan, P.C.	15(b), 41, 70
Schumacher & Hickey	15(e), 41, 71
Frederick R. Schumacher Ltd., A Professional Law Corporation	15(f), 41, 72
Somers Altenbach	15(c), 41, 68
Robert E. Altenbach	15(d), 41, 68
Peat, Marwick, Mitchell & Co.	17(a), 43-44, 60
Fox & Company	17(b), 43-44, 61
Petrotec Systems, A.G.	54
Petrotec Systems, Inc.	54
Petrogenetic Systems, A.G.	54
Petrotec Holdings, A.G.	54
Petrotec Marketing Corporation	54
Petrotec Development and Production, Ltd.	54
Petrotec Lugano, A.G.	54
Pax-Innovations Foundation	54
Columbus Valley, N.V.	54
Mardyn, N.V.	54
Nelantex	54
Narod, N.V.	54
Tulsebond, Ltd.	54
Shaleelectric, S.A.	54
Finagest, A.G.	54
Tamaro Holding, Inc.	54
Elektra Energie, A.V.	54

121. In making their purchases of interests in the Oil Technology Group Partnerships, plaintiffs and the members of the

class relied on the representations made by defendants which form the basis for this claim. As a direct and proximate result of defendants' conduct, plaintiffs and the members of the class suffered substantial damages in connection with their purchases of interests in the Oil Technology Group Partnerships.

NINTH CLAIM

FOR FRAUD AND DECEIT

122. Plaintiffs reallege and incorporate herein by this reference each and every allegation contained in paragraphs 1-48, 51-73, 77-91, and 119-120.

123. This Ninth Claim is asserted by plaintiffs, on behalf of themselves and the members of the class, against all defendants and is based upon a pendent state law claim for fraud and deceit.

124. As a direct and proximate result of the aforesaid conduct, plaintiffs and the members of the class suffered substantial damage in connection with their purchases of interests in the Oil Technology Group Partnerships.

TENTH CLAIM

FOR CONSPIRACY TO DEFRAUD

125. Plaintiffs reallege and incorporate by this reference each and every allegation contained in paragraphs 1-48, 51-73, 77-91, and 119-120.

126. This Tenth Claim is brought by plaintiffs, on behalf of themselves and the members of the class, against all defendants, each of whom knowingly and willfully joined together in a conspiracy to defraud plaintiffs and the members of the class in connection with their purchases of interests in the Oil Technology Group Partnership.

127. As a direct and proximate result of the aforesaid conduct, plaintiffs and the members of the class suffered substan-

tial damage in connection with their purchases of interests in the Oil Technology Group Partnerships.

ELEVENTH CLAIM

FOR PROFESSIONAL MALPRACTICE

128. Plaintiffs reallege and incorporate by this reference each and every allegation contained in paragraphs 1-48, 51-73, 77-91.

129. This Eleventh Claim is based on a pendent state law claim for professional malpractice and is asserted by plaintiffs, on behalf of themselves and the members of the class, against Peat, Marwick, Mitchell & Co., Fox & Company, Somers & Altenbach, Robert E. Altenbach, Baskin & Sears, Friedman & Shaftan, P.C., Schumacher & Hickey, Frederick M. Schumacher, Ltd., A Professional Law Corporation, Houston Harbaugh, Lewin Energy Corporation, Lewis and Associates, Inc., Vello A. Kuuskraa, CLD Group, Inc., Technology Catalysts, R.L. DiCicco, and Todd Michael Doscher.

130. All defendants named in this claim held themselves out as experts in connection with either the tax opinions or title opinions included in the confidential memoranda, the financial statements, notes thereto, tax returns disseminated to plaintiffs and members of the class, the geological and financial analysis reports included in the confidential memoranda or the opinion on Hemisphere's portfolio of EOR technology included in the confidential memoranda, as hereinabove more specifically alleged. Each of the defendants named in this claim who prepared an opinion included in the confidential memoranda consented to its inclusion and did so with the intent that said opinions and reports would be relied upon by plaintiffs and the members of the class in connection with their purchases of interests in the Oil Technology Group Partnerships. In addition, defendants Peat and Fox rendered their reports on the partnerships' financial statements and notes thereto and issued tax returns with the intent that plaintiffs rely thereon in connec-

tion with their purchases of interests in the Oil Technology Group Partnerships.

131. As a result of their purported expertise, the defendants named in this claim owed plaintiffs and the members of the class a duty of due care and reasonable conduct. The defendants named in this claim breached said duty by acting recklessly and knowingly in connection with the issuance of said documents, as hereinabove alleged.

132. As a direct and proximate result of the aforesaid conduct, plaintiffs and the members of the class suffered substantial damage in connection with their purchases of interests in the Oil Technology Group Partnerships.

TWELFTH CLAIM

FOR VIOLATION OF SECTIONS 1962(c) AND (d) OF THE RACKETEER INFLUENCED AND CORRUPT ORGANIZATIONS ACT

133. Plaintiffs reallege and incorporate by this reference each and every allegation contained in paragraphs 1-48, 51-73 and 77-91.

134. This Twelfth Claim is asserted by plaintiffs on behalf of themselves and the members of the class, against all defendants, and is based on a claim for violation of Sections 1963(c) and (d) of the Racketeer Influenced and Corrupt Organizations Act, 18 U.S.C. §§ 1962 (c) and (d).

135. The defendants herein were obligated by law to ensure that the confidential memoranda, financial statements, notes thereto, and tax returns disseminated to investors in connection with their purchases of interests in the Oil Technology Group Partnerships did not contain any material misrepresentations or omissions of material fact. The defendants knowingly, recklessly or otherwise culpably issued said documents for the purpose of enriching themselves at the expense of plaintiffs and the members of the plaintiff class.

136. All of the defendants were, at times relevant to the events alleged herein, associated with an enterprise engaged in interstate and foreign commerce and the activities of which effect interstate commerce. That enterprise is the Petrotec companies, including Petrotec Systems, A.G., Petrotec Systems, Inc., Petrogenetics Systems, A.G., and Petrotec Holdings, A.G., which are in the business of, *inter alia*, licensing and cross-licensing energy-related processes and technologies and the development of bio-surfactants for use in EOR, pollution clean-up, and gene-splicing, and many of which entities were in existence and conducting business prior to the formulation of the conspiracy to defraud herein alleged. In the alternative, the enterprise is an association in fact of the defendants and their affiliated companies.

137. The defendants have engaged and participated in a pattern of racketeering activity by virtue of the dissemination of false and misleading statements, including the confidential memoranda, financial statements and notes thereto, and the tax returns, as hereinabove alleged, by the use of the United States mail and by use of the telephone and telegraph wires, in violation of 18 U.S.C §§ 1341 and 1343, respectively, and by repeated acts of securities fraud, as hereinabove alleged. Each of defendants' racketeering activities was taken for the purpose of furthering defendants' plan, concerted scheme, conspiracy and common course of conduct to induce plaintiffs and the members of the plaintiff class to purchase interests in the Oil Technology Group Partnerships. Moreover, each such act of mail, wire and securities fraud was carried out by common perpetrators, using common methods of commission, as detailed hereinabove. Furthermore, the acts of mail, wire and securities fraud occurred at different times over at least a four-year period, *i.e.*, 1979-1983.

138. As a direct and proximate result of the aforesaid conduct, plaintiffs and the members of the class have been injured in their business or property in connection with their purchases or interests in the Oil Technology Group Partnerships and seek treble damages, costs of suit and attorneys' fees by reason thereof pursuant to 18 U.S.C. § 1964(c).

THIRTEENTH CLAIM

FOR VIOLATION OF THE CALIFORNIA CORPORATE SECURITIES LAWS OF 1968

139. Plaintiffs reallege and incorporate by this reference each and every allegation contained in paragraphs 1-48, 51-73, 77-91, 95, 99-101 and 108-113.

140. This Thirteenth Claim is asserted by plaintiffs, on behalf of themselves and the members of the class, against the defendants specified below and is based upon violations of Sections 25400(d), 25500, 25401, 25501, 25504, 25504.1 and 25504.2 of the California Corporate Securities Law of 1968, as hereinafter more specifically alleged.

141. The Oil Technology Group Partnerships and the general partners thereof (*i.e.*, Louis F. Coppage, Richard B. Basile, Gary E. Krause, GEDCO, AER, and Energy Resources, Inc.) Werner Heim, Max W. Hilpert, and Winsor T. Savery were among the issuers of interests in the Oil Technology Group Partnerships and directly sold interests therein to plaintiffs and the members of the plaintiff class by means of confidential memoranda containing untrue statements of material facts and omitted to state material facts necessary in order to make the statements made, in light of the circumstances under which they were made, not misleading to the plaintiffs and other members of the class, as more fully alleged hereinabove, in violation of Sections 25400(c), 25500, 25401 and 25501.

142. The Petrotec Entities (excluding GEDCO, AER and Energy Associates, Inc.), James A. Cunningham, Neil E. Rogen, Greg E. Bogdan, Darrell D. McCullough, T. Kenneth Pyles, Robert LaGuardia, William R. Conklin, C. Norris Taylor, Jr., aided and abetted the defendants who violated Section 25401, as identified in paragraph 141 hereinabove. Each of the defendants named in this paragraph who are alleged to have violated Section 25504.1 did so with the intent to deceive or defraud plaintiffs and the members of the plaintiff class.

143. The Petrotec Entities, Werner Heim, Winsor T. Savery, Louis F. Coppage, Richard B. Basile, Gary E. Krause, Neil E. Rogen, Max W. Hilpert, James A. Cunningham, T. Kenneth Pyles, Greg E. Bogdan, William Conklin, Darrel D. McCullough, Robert Laguardia and C. Norris Taylor, Jr., controlled within the meaning of Section 25504, the defendants alleged to be liable for violating Section 25401, as identified in paragraph 141 hereinabove.

144. Defendants Somers & Altenbach, Robert E. Altenbach, Baskins & Sears, Friedman & Shaftan, Schumacher & Hickey, Frederick R. Schumacher, Ltd., A Professional Law Corporation, Houston Harbaugh, Peat, Marwick, Mitchell & Co., Fox & Company, Lewin Energy Corporation, Lewin and Associates, Inc., Technology Catalysts, Inc., CLD Group, Inc., Vello A. Kruskraa and R. L. DiCicco are either accountants, engineers, or other professionals who consented to the inclusion in the confidential memoranda, the opinions and/or reports they prepared, as more fully alleged hereinabove. Each of said opinions and reports included untrue statements of material fact or omitted to state material facts necessary in order for the statements made, in light of the circumstances under which they were made, not misleading. In making their purchases of interests in the Oil Technology Group Partnerships, plaintiffs and the members of the class relied on the opinions and reports identified in this paragraph, and were damaged thereby. Accordingly, the defendants named in this paragraph violated Section 25504.2.

145. As a direct and proximate result of the aforesaid conduct, plaintiffs and the members of the class suffered substantial damage in connection with their purchases of interests in the Oil Technology Group Partnerships.

FOURTEENTH CLAIM

FOR IMPOSITION OF A CONSTRUCTIVE TRUST

146. Plaintiffs reallege and incorporate by this reference each and every allegation contained in paragraphs 1-48, 51-73 and 77-91.

147. This Fourteenth Claim is asserted by plaintiffs on behalf of themselves and the members of the class against the Petrotec Entities, the Oil Technology Group Partnerships, Werner Heim, Max W. Hilpert, Winsor T. Savery, Louis F. Coppage, Richard B. Basile and Gary E. Krause.

148. The defendants named in this Fourteenth Claim obtained substantial sums of money from plaintiffs and the members of the class by virtue of fraud and/or negligence in connection with the offer and sale of limited partnership interests in the Oil Technology Group Partnerships. Moreover, as general partners and managers of the Petrotec Entities and partnerships, defendants are fiduciaries to plaintiffs who reposed trust and confidence in defendants in the operation and management of said partnerships.

149. In breach of this trust, defendants have caused to be transferred to various bank accounts and trusts in the United States, Switzerland, Liechtenstein and elsewhere, whose locations are unknown to plaintiffs but are known to the defendants, the monies wrongfully obtained from plaintiffs, and have taken title thereto in their own names.

150. By virtue of defendants' wrongful conduct, a constructive trust should accordingly be imposed on said monies.

PRAYER FOR RELIEF

WHEREFORE, plaintiffs, on behalf of themselves and the plaintiff class, as hereinabove defined, pray for judgment:

1. Ordering rescission to plaintiffs and each member of the class hereinabove defined, or awarding them the damages suffered as a result of the wrongs complained of herein;

2. Declaring this action to be a proper plaintiff class action, as hereinabove alleged;

3. Awarding punitive damages against defendants, and each of them, in an amount deemed just and proper by this Court;

4. Awarding plaintiffs treble damages, costs of court and attorneys' fees pursuant to 18 U.S.C. § 1964(c);

5. Awarding plaintiffs their costs of court and the costs and expenses of this litigation, including reasonable attorneys', accountants' and experts' fees;

6. Imposing a constructive trust on the monies defendants fraudulently and/or negligently obtained from plaintiffs;

7. Granting such other and further relief as the Court may deem just and proper.

DAVID B. GOLD
A PROFESSIONAL LAW CORPORATION
DAVID B. GOLD, ESQ.
GEORGE DONALDSON, ESQ.
SOLOMON B. CERA, ESQ.

Dated: __________ By: ______________________
Solomon B. Cera

and

LAW OFFICES OF WOODFORD G. ROWLAND
WOODFORD G. ROWLAND, ESQ.

Dated: __________ By: ______________________
Woodford G. Rowland

Attorneys for Plaintiffs and
All Others Similarly Situated

DEMAND FOR JURY TRIAL

Plaintiffs hereby demand trial by jury of all issues as allowed by law.

DAVID B. GOLD
A PROFESSIONAL LAW CORPORATION
DAVID B. GOLD, ESQ.
GEORGE DONALDSON, ESQ.
SOLOMON B. CERA, ESQ.

Dated: __________ By: ______________________
Solomon B. Cera

and

LAW OFFICES OF WOODFORD G. ROWLAND
WOODFORD G. ROWLAND, ESQ.

Dated: __________ By: ______________________
Woodford G. Rowland

Attorneys for Plaintiffs and
All Others Similarly Situated

(2)

No. 89-475

In the Supreme Court

OF THE

United States

October Term, 1989

Peat Marwick Main & Co.,
Petitioner,

vs.

Philip D. Roberts, et al.,
Respondents.

BRIEF IN OPPOSITION TO PETITION FOR A WRIT OF CERTIORARI

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QUESTION PRESENTED

Did respondents state a cause of action for aiding and abetting a violation of Section 10(b) of the Securities Exchange Act of 1934 (the "Exchange Act"), 15 U.S.C. § 78j(b), against Peat Marwick Main & Co. ("Peat Marwick"), a nationally recognized public accounting firm, sufficient to withstand a motion to dismiss under Rule 12(b)(6), Fed.R.Civ.P., where they alleged that Peat Marwick: (i) participated in the preparation of allegedly false and misleading offering documents on which respondents relied in investing approximately forty-five million dollars ($45,000,000) in cash in unregistered limited partnership interests; (ii) consented to the use of its name in such offering documents after having learned of their falsity by virtue of an investigation it conducted, thereby inviting the investing public to rely on the firm's reputation as a selling tool and as evidence of the genuiness of the offerings; (iii) had effective control over the occurrence of the offerings; and (iv) subsequent to dissemination of the allegedly false and misleading offering documents, rendered allegedly false and misleading audit reports on partnership financial statements and disseminated allegedly false and misleading tax forms on which respondents relied in making additional capital contributions to the partnerships.

PARTIES BELOW

Respondents Philip D. and Lynn Roberts, Denny and Karen Delk, Jack T. Bell, and Arthur B. Gauss are representatives of a class, certified pursuant to Rule 23(b)(3), Fed.R.Civ.P., defined to include all persons and entities, excluding any defendants, who purchased or otherwise acquired an interest in any of thirty-eight limited partnerships named as defendants below. Complaint ¶ 12.

Petitioner Peat Marwick Main & Co. is a partnership of certified public accountants and is the successor-in-interest to Peat, Marwick, Mitchell & Co., which was named as a defendant below.

Houston Harbaugh, P.C. was a defendant/appellee below but is not a party to this proceeding.

The American Institute of Certified Public Accountants and Lomas Mortgage U.S.A., Inc. participated as *amicus curiae* on behalf of petitioner in the United States Court of Appeals for the Ninth Circuit.

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No. 89-475

In the Supreme Court

OF THE

United States

OCTOBER TERM, 1989

PEAT MARWICK MAIN & CO.,
Petitioner,

VS.

PHILIP D. ROBERTS, et al.,
Respondents.

BRIEF IN OPPOSITION TO PETITION FOR A WRIT OF CERTIORARI

STATEMENT OF THE CASE

A. The Underlying Litigation

The underlying litigation was initiated on December 31, 1984 when certain of the respondents, together with other individuals not parties hereto, filed a class action complaint in the United States District Court for the Northern District of California against various defendants, including Peat Marwick. In essence, respondents alleged that they sustained damages as a result of their purchase of limited partnership interests in reliance on offering memoranda which omitted and misrepresentated material facts in violation of the antifraud provisions of the federal securities laws and state law.

Respondents claim that the offering memoranda omitted to state that their partnership investments were part of a single, interrelated and integrated fraud scheme by which thirty-eight (38) limited partnerships were formed and sold purportedly to engage in the application of certain enhanced oil recovery

("EOR") technologies to oil-bearing properties. Pursuant to the offerings, the partnerships' promoters collected two hundred million dollars ($200,000,000) in cash from the members of the class.[1] In addition, it was represented in the offering memoranda that investors would be able to claim certain tax deductions as a result of their investments. However, the Internal Revenue Service ("IRS") disallowed these tax deductions in their entirety, and has claimed that the United States has been wrongfully deprived of one billion two hundred million dollars ($1,200,000,000) in tax revenues as a result of the alleged fraudulent scheme. *See generally Krause v. Commissioner*, 92 T.C. 11 (1989) (discussing the contention that certain of the partnerships at issue are abusive tax shelters).

In claiming that their partnership investments were part of an integrated fraud scheme, respondents also allege that: (i) the represented tax benefits were not available from the inception of the offerings; (ii) that the EOR technologies purportedly licensed by the partnerships were either known to be ineffectual or were licensed by the partnerships from related parties at grossly inflated prices; (iii) that the partnerships acquired interests in properties from undisclosed partnership promoters at inflated prices; and (iv) that the partnership interests were offered and sold in violation of the registration requirements of the Securities Act of 1933.[2]

B. The Role Of Peat Marwick In The Alleged Fraud

Peat Marwick's request to invoke this Court's jurisdiction is based on an erroneous premise. Thus, it is argued that the United States Court of Appeals for the Ninth Circuit erred in reversing the district court's dismissal with prejudice, pursuant to Rule

[1] The offerings in which Peat Marwick was directly involved resulted in cash investments of approximately forty-five million dollars ($45,000,000).

[2] Peat Marwick incorrectly states that the sole basis for respondents' claims is the failure of the EOR technologies. Petition for Certiorari at 4. As noted, respondents' allegations focus on several aspects of the partnership offerings, only one of which concerns the technologies.

12(b)(6), Fed.R.Civ.P., of respondents' claim against Peat Marwick for aiding and abetting a violation of Section 10(b) of the Exchange Act, because the only allegation as to Peat Marwick was the truthful statement that the firm agreed to perform accounting services for the partnerships in the future. Petition for Certiorari at 3.

However, as the Ninth Circuit correctly observed in reversing the district court's improvident dismissal of respondents' claim, the facts which give rise to the claim for relief against Peat Marwick go well beyond mere "agreement to provide future services." As the Ninth Circuit noted,

> In substance, the investors' fourth amended complaint recited the following facts, the truth of which is presently assumed: (1) the offering documents indicated that Peat, Marwick agreed to perform accounting services for the partnerships; (2) before Peat, Marwick agreed to perform future services, it reviewed the offering memoranda and investigated partnership management, learning of fraudulent material; (3) through this process, Peat, Marwick participated in drafting the memoranda or had effective control over the contents by consenting to the use of its name; (4) Peat, Marwick audited and opined on the financial statements of, and prepared the tax returns for the partnerships for the years ending December 31, 1981, December 31, 1982, December 31, 1983, and December 31, 1984; (5) these opinions were disseminated to the investors; (6) by assisting in the preparation of the memoranda and its investigation of the management of the partnerships, Peat, Marwick knew in what respects the memoranda were false and misleading, and furthered the fraud by consenting to inclusion of its name.

Roberts v. Peat, Marwick, Mitchell & Co., 857 F.2d 646, 652 (9th Cir. 1988).

The Ninth Circuit's accurate statement of respondents' allegation highlights the fatal error of Peat Marwick's petition. In its zeal to capture this Court's attention, Peat Marwick misstates respondents' allegation in a futile attempt to show that the Ninth

Circuit's decision constitutes an extension of existing law and conflicts with authority from other circuits.

Contrary to Peat Marwick's contention, however, respondents' aiding and abetting allegation is not based *solely* on what Peat Marwick self-servingly characterizes as its "silence or inaction" in the face of its alleged knowledge that a fraud was afoot. Instead, Peat Marwick is alleged to have engaged in manipulative and deceptive conduct by participating in the preparation of false and misleading offering documents, agreeing to lend its name and credibility to such materials while knowing they were infected with fraud, and by continuing to participate in a fraudulent scheme through dissemination of allegedly false and misleading audit reports and tax forms which respondents relied on in making additional cash contributions over a period of several years. This demonstrates the folly of Peat Marwick's assertion that respondents' claim is merely that Peat Marwick remained silent about the alleged fraud when it had no independent duty to disclose and, therefore, no aiding and abetting claim will lie.

Peat Marwick audited and opined on the financial statements for at least five (5) of the partnerships syndicated in 1981. Complaint ¶ 17(a). The offering memoranda for those partnerships represented that Peat Marwick would perform accounting services therefore, including preparing reports on audited partnership financial statements. *Id.* Subsequent to dissemination of Peat Marwick's report on the financial statements for the 1981 partnerships, it continued to permit its name to be used in offering memoranda for two (2) partnerships syndicated in 1982. *Id.* Obviously, then, this case involves far more than Peat Marwick's silence or inaction. It involves Peat Marwick's participation in preparation of allegedly false and misleading 1981 offering memoranda, rendition of audit services to those partnerships, including issuance of unqualified opinions on their financial statements, followed by dissemination of new partnership offering memoranda which continued to reflect Peat Marwick's participation.[3] Indeed,

[3] One of the partnership offering memoranda actually contained a report on the financial statement of one of the issuing entities. Complaint ¶ 17(a).

Peat Marwick continued to render reports on partnership financial statements and tax forms into 1984. This hardly bespeaks "silence or inaction" on the part of Peat Marwick.[4]

The Ninth Circuit reversed the district court precisely because the lower court misconstrued respondents' allegation in the same manner in which it is erroneously presented by Peat Marwick in its petition. *Roberts v. Heim*, 670 F. Supp. 1466, 1482 (N.D. Cal. 1987), *aff'd in part and rev'd in part sub nom. Roberts v. Peat, Marwick, Mitchell & Co.*, 857 F.2d 646, 652-653 (9th Cir. 1988).[5] As discussed below, there cannot be any serious question that under the applicable pleading standards which must be applied,

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[4] The significance of these facts cannot be understated. By way of example, respondent Arthur B. Gauss purchased an interest in a 1982 partnership pursuant to an offering memorandum which represented that Peat Marwick would provide future accounting services, including preparation of reports on audited partnership financial statements. By the time Dr. Gauss invested, Peat Marwick had completed its audit of the 1981 partnerships and had rendered unqualified opinions on those partnerships' financial statements. These 1981 partnerships were identified in the offering memorandum relied on by Dr. Gauss in purchasing his interest in a virtually identical 1982 partnership. Obviously, had Peat Marwick declined to render an unqualified report on the 1981 partnership financial statements, or at least qualified its report thereon, Dr. Gauss would likely never have been offered the opportunity to invest in a 1982 partnership or, if he had, would have been alerted to the possibility of a fraud. As a result, it cannot seriously be questioned that Peat Marwick engaged in a manipulative and deceptive act in agreeing to be identified in the 1982 partnership offering memoranda after completing its audit of the 1981 partnerships' financial statements.

[5] The district court's analysis of Peat Marwick's motion to dismiss consisted of one paragraph in a twenty-five (25) page opinion which addressed complex issues concerning class certification, motions to dismiss, and motions for summary judgment brought by virtually all of the one hundred three (103) defendants named below. *Roberts v. Heim, supra*, 670 F.Supp. 1466. Perhaps this explains the district court's failure to address the totality of the factual allegations made against Peat Marwick.

respondents alleged a cognizable claim for relief against Peat Marwick as an aider and abettor of a securities fraud.[6]

C. Procedural Background Giving Rise To The Petition For A Writ of Certiorari

The relevant complaint for purposes of this proceeding is respondents' one hundred fifty-three (153) page Fourth Amended Complaint, filed June 16, 1986. Respondents alleged therein claims against Peat Marwick for, *inter alia,* primary and secondary violations of Section 10(b) of the Exchange Act and Rule 10b-5 promulgated thereunder, 17 C.F.R. ¶ 240.10b-5. The district court entered summary judgment in favor of Peat Marwick on the primary violation claim and dismissed the aiding and abetting claim with prejudice. 670 F.Supp. 1466, 1474, 1482. Following entry of judgment pursuant to Rule 54(b), Fed.R.Civ.P., respondents appealed. In a *per curiam* opinion the Ninth Circuit affirmed the summary judgment but reversed the dismissal of the aiding and abetting claim. 857 F.2d at 648, 652.

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[6] Respondents alleged that the reports on financial statements and Form K-1 tax forms prepared by Peat Marwick gave rise to a claim for primary liability under Section 10(b) of the Exchange Act. Summary judgment on this claim in favor of Peat Marwick was affirmed by the Ninth Circuit on the ground that payments on promissory notes made after initial cash contributions were not separate purchases of securities. 875 F.2d at 649-652. Nonetheless, as the Ninth Circuit noted, Peat Marwick's continuing involvement in the offerings by virtue of its preparation of these documents, which were disseminated to and relied on by limited partners prior to making additional cash contributions, supports the allegation that Peat Marwick knowingly rendered substantial assistance to a fraudulent scheme. The fact that the allegations respecting Peat's audit reports and tax returns were set forth within respondents' primary violation claim is irrelevant. Complaint ¶¶ 43(a), 60(a). It is well settled that, "[t]he entire pleading will be scrutinized to determine if any legally cognizable claim can be found within it . . . A pleading will be judged by its substance rather than according to its form or label and, if possible, will be construed to give effect to all its avertments." 5 Wright & Miller, *Federal Practice and Procedure,* ¶ 1286 at 383 (2d Ed. 1969) (footnotes omitted); see also *Walker v. KFC Corp.,* 515 F.Supp. 612, 619 (S.D. Cal. 1981), *modified on other grounds,* 728 F.2d 1215 (9th Cir. 1984).

Peat Marwick's Petition for Rehearing with Suggestion for Rehearing *En Banc* in the Ninth Circuit failed to draw a single supporting vote. The instant petition for a writ of certiorari followed.

D. The Legal Issues Raised By The Petition For A Writ of Certiorari

The petition for a writ of certiorari seeks this Court's review of a legal issue which has been resolved in a uniform manner by the courts of appeals on numerous occasions. Thus, there can be no dispute that all of the circuit courts have held that a private cause of action exists for aiding and abetting a violation of Section 10(b) of the Exchange Act and that three elements must be established in order for liability to attach: (1) the existence of a primary wrong; (2) knowledge on the part of the aider and abettor of the wrong; and (3) the aider and abettor's substantial assistance in the wrong. *E.g., Rochez Brothers, Inc. v. Rhoades*, 527 F.2d 880, 886 (3d Cir. 1975); *SEC v. Rogers*, 790 F.2d 1450, 1460 (9th Cir. 1986); Comment, *Aiding And Abetting Liability Under Securities Exchange Act Section 10(b) and SEC Rule 10b-5: The Infusion of A Sliding-Scale, Flexible-Factor Analysis*, 22 Loy.L.A.Rev. 1189, 1192-93 (June 1989).

Peat Marwick contends, however, that a "conflict" exists among certain of the circuit courts because, it is claimed, the Seventh and Second Circuits have held that an "independent" duty to disclose must exist before silence can give rise to liability, whereas the Ninth and Eleventh Circuits have held that participation in a fraudulent scheme may give rise to liability on the part of an alleged aider and abettor, even in the absence of an "independent" duty to disclose. Petition for Certiorari at 9.

There are three fundamental problems with these contentions. First, there are no conflicts among the circuit courts as to the existence of a private cause of action for aiding and abetting a violation of Section 10(b) or the elements of such a claim. Merely because some courts have applied the elements of the aiding and abetting claim to different factual scenarios in different ways does not constitute a "conflict" sufficient to invoke this Court's jurisdiction. Secondly, contrary to Peat Marwick's asser-

tion, this is *not* a case about silence or inaction. As a result, even if there were a conflict among the circuits respecting whether or not silence is actionable as aiding and abetting absent an "independent" duty to disclose, that issue simply is not raised by this case. In any event, the cases are consistent in holding that the existence or non-existence of a duty to disclose relates only to the degree of *scienter* required in order to find an aider and abettor liable, not whether the claim is valid in the first instance. *E.g., Sirota v. Solitron Devices, Inc.*, 673 F.2d 566, 575 (2d Cir.), *cert. denied*, 459 U.S. 838 (1982); *IIT, An International Investment Trust v. Cornfeld*, 619 F.2d 909, 927 (2d Cir. 1980); *Monsen v. Consolidated Dressed Beef Co.*, 579 F.2d 793, 800 (3d Cir.), *cert. denied*, 439 U .S. 930 (1978). Finally, the *in terrorem* effects Peat Marwick claims will arise if the Ninth Circuit's decision is allowed to stand are illusory. Contrary to such hyperbole, the decision in *Roberts* will not permit a securities plaintiff to allege aiding and abetting liability against professionals whose *only* involvement is lending their names to an offering. As noted, the Ninth Circuit upheld the sufficiency of respondents' allegation because Peat Marwick is alleged to have been deeply embroiled in a fraudulent scheme over a number of years, starting with its participation in the preparation of false and misleading offering materials and continuing through issuance of unqualified reports on partnership financial statements and tax forms. As such, this case is not the appropriate vehicle to review the issues raised by Peat Marwick which were neither briefed or decided below and have little, if any, relevance to the allegation made by respondents.

REASONS FOR DENYING THE WRIT

I

THE WRIT SHOULD BE DENIED BECAUSE IT SEEKS REVIEW OF AN ISSUE WHICH WAS NOT BRIEFED OR DECIDED BELOW AND AS TO WHICH THERE IS UNANIMITY OF OPINION AMONG THE COURTS OF APPEALS

Peat Marwick seeks review of the Ninth Circuit's decision in *Roberts* in order to give this Court the opportunity to resolve the previously reserved question of whether or not a private cause of action exists for aiding and abetting a violation of Section 10(b) of the Exchange Act.[7] For several reasons, this issue should not be resolved by this Court in the context of this case.

First, the issue of the existence of a private cause of action for aiding and abetting a violation of Section 10(b) of the Exchange Act was not briefed, argued, or addressed in either the district court or the Ninth Circuit and thus should not be considered by this Court in the context of this case. Secondly, for sound legal and policy reasons, the courts of appeals unanimously hold that a private cause of action for aiding and abetting a violation of Section 10(b) of the Exchange Act exists. Finally, Peat Marwick has failed to articulate any compelling reason why the Court should take this opportunity to do away with aiding and abetting liability, which is an important tool in the private enforcement of the nation's securities laws.

As a general rule, this Court will not review issues not considered by the district court or the court of appeals. *E.g., Miree v. DeKalb County, GA.*, 433 U.S. 25, 33-34 (1977) ("the fact that this asserted basis of liability is so obviously an afterthought may be some indication of its merit, but since it was neither pleaded, argued, nor briefed in the District Court or the Court of Appeals, we will not consider it"); *Adickes v. S.H. Kress and Co.*, 398 U.S.

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[7] In *Ernst & Ernst v. Hochfelder*, 425 U.S. 185, 192 n.2 (1976), this Court reserved decision on the question of whether civil liability for aiding and abetting a violation of Section 10(b) of the Exchange Act and Rule 10b-5 promulgated thereunder is appropriate.

144, 147 n.2 (1970) (where issues are neither raised before nor considered by the Court of Appeals, this Court will not ordinarily consider them). In this case, the issue of the existence *vel non* of a private cause of action for aiding and abetting a violation of Section 10(b) of the Exchange Act has simply never previously been raised or decided. For this reason alone, the petition for a writ of certiorari should be denied.

In addition to the fact that the issue sought to be reviewed was neither raised or decided below, the circuit courts unanimously hold that there exists a private cause of action for aiding and abetting a violation of Section 10(b) of the Exchange Act.[8] Accordingly, there is no conflict among the courts of appeals as to this issue, within the meaning of Supreme Court Rule 17.1(a). Moreover, given the uniformity of opinion among the circuit courts on this issue, it appears that it is not the type of important question of federal law which compels resolution by this Court at this time. Supreme Court Rule 17.1(c).

Merely because this Court has previously reserved decision on an issue does not mean that review thereof is necessary. For example, this Court has never directly faced the issue of whether there exists an implied private right of action for violations of Section 10(b) of the Exchange Act but, rather, has repeatedly accepted the existence of such a cause of action. *E.g.*, *Herman &*

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[8] *See, e.g., Cleary v. Perfectune, Inc.*, 700 F.2d 774, 777 (1st Cir. 1983); *Edwards & Hanly v. Wells Fargo Securities Clearance Corp.*, 602 F.2d 478, 484 (2d Cir. 1979), *cert. denied*, 444 U.S. 1045 (1980); *Monsen v. Consolidated Dressed Beef Co., Inc., supra*, 579 F.2d at 799; *Pargas, Inc. v. Empire Gas Corp.*, 423 F.Supp. 199, 240-41 (D. Md.), *aff'd*, 546 F.2d 25 (4th Cir. 1976); *Woodward v. Metro Bank of Dallas*, 522 F.2d 84, 97 (5th Cir. 1975); *SEC v. Coffey*, 493 F.2d 1304, 1315 (6th Cir. 1974), *cert. denied*, 420 U.S. 908 (1975); *Sundstrand Corp. v. Sun Chem. Corp.*, 553 F.2d 1033, 1043 (7th Cir.) *cert. denied*, 434 U.S. 875 (1977); *Metge v. Baehler*, 762 F.2d 621 (8th Cir. 1985), *cert. denied*, 474 U.S. 1057 (1986); *Jett v. Sunderman*, 840 F.2d 1487, 1491 (9th Cir. 1988); *Zabriskie v. Lewis*, 507 F.2d 546, 553 (10th Cir. 1974); *Woods v. Barnett Bank of Ft. Lauderdale*, 765 F.2d 1004, 1009-10 (11th Cir. 1985); *Investors Research Corp. v. SEC*, 628 F.2d 168, 177 (D.C. Cir.), *cert. denied*, 449 U.S. 919 (1980).

MacLean v. Huddleston, 459 U.S. 375, 380 n. 10 (1983) (because the courts had "consistently recognized for more than 35 years" an implied private right of action under Section 10(b) and Rule 10b-5 of the Securities Exchange Act of 1934, the issue was "simply beyond peradventure"); *Blue Chip Stamps v. Manor Drug Stores*, 421 U.S. 723, 730 (1975) (twenty five years after the first district court held that there was an implied right of action under Rule 10b-5 of the Securities Exchange Act of 1934, the Court "confirmed with virtually no discussion the overwhelming consensus of the District Courts and Courts of Appeals that such a cause of action did exist.") (quoted with approval in *Merrill, Lynch, Pierce, Fenner & Smith, Inc. v. Curran*, 456 U.S. 353, 380 (1982)).

A similar circumstance applies to the private cause of action for aiding and abetting a violation of Section 10(b) of the Exchange Act. Recognition of the existence of such a private cause of action appears to stem from the seminal decision in *Brennan v. Midwestern United Life Ins. Co.*, 259 F.Supp. 673, 680-681 (N.D. Ind. 1966) (motion to dismiss denied), 286 F.Supp. 702 (N.D. Ind. 1968) (on merits after trial), *aff'd*, 417 F.2d 147 (7th Cir. 1969), *cert. denied*, 397 U.S. 989 (1970). Inasmuch as the existence of a private cause of action for aiding and abetting a violation of Section 10(b) of the Exchange Act has, since *Brennan*, been repeatedly recognized in the federal courts for more than twenty-three (23) years, there can be no serious question that such a cause of action is properly ensconced within Exchange Act jurisprudence.

In the face of this compelling history, the attempt to show that the well-established private cause of action for aiding and abetting a violation of Section 10(b) of the Exchange Act somehow contravenes the intent of Congress or is inconsistent with the statute itself should be rejected. In *Massachusetts Mutual Life Ins. Co. v. Russell*, 473 U.S. 134 (1985), this Court reaffirmed that congressional intent and statutory consistency constitute the "essential predicate for implication of a private remedy." *Id.* at

145 *citing Northwest Airlines, Inc. v. Transport Workers*, 451 U.S. 77 (1981).[9]

Significant here is the fact that congressional intent to imply a private right of action may be inferred in a situation where there has been a routine and consistent recognition by the federal courts that such a cause of action exists. *Scientex Corp. v. Kay*, 689 F.2d 879, 884 (9th Cir. 1982). Precisely that scenario exists here. The district courts and courts of appeals have "routinely and consistently" recognized the existence of a private cause of action for aiding and abetting a violation of Section 10(b) of the Exchange Act.

That Congress intended such a cause of action to remain unimpaired is confirmed by the legislative history. Congress has repeatedly rejected attempts to amend the federal securities laws to prohibit aiding and abetting as a violation of Section 10(b) of the Exchange Act. In 1975, the most comprehensive revisions of the federal securities laws that have occurred since passage of the Exchange Act were enacted, and no limitations were legislated on the private cause of action for aiding and abetting a violation of Section 10(b) of the Exchange Act, notwithstanding that such a cause of action had repeatedly been employed in federal decisional law. See *Herman & MacLean v. Huddleston, supra*, 459 U.S. at 384-385 (describing the 1975 legislation). By 1983, a congressional report had specifically endorsed, "the judicial application of aiding and abetting liability to achieve the remedial purposes of the securities laws."[10] Furthermore, Section 28(a) of

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[9] Much of Peat Marwick's argument in this connection is based on an almost decade old law review article espousing an extreme view of application of aiding and abetting principles in the context of the federal securities laws which, to our knowledge, has never been adopted. Fischel, *Secondary Liability Under Section 10(b) of the Securities Act [sic] of 1934*, 69 Calif.L.Rev. 80 (1981).

[10] H.R. Rep. No. 355, 98th Cong., 2d Sess 10 (1983) *reprinted* in 1984 U.S. Code Cong. & Admin. News 2274, 2283. This extended a treble damages civil penalty in SEC enforcement actions to persons who aided or abetted insider trading violations by tipping. This authority was removed by the Insider Trading and Securities Fraud Enforcement Act

the Exchange Act contains an explicit saving clause which provides that, "[t]he rights and remedies provided by this title shall be in addition to any and all other rights and remedies that may exist at law or in equity." 15 U.S.C. § 78bb(a). Finally, courts have recognized that, in the absence of aiding and abetting liability under Section 10(b), the basic remedial purposes of the Exchange Act could be circumvented with impunity. *E.g.*, *Aldrich v. New York Stock Exchange*, 446 F.Supp. 348, 355 n.5 (S.D.N.Y. 1977). This undesirable result would leave defrauded investors with no federal remedy against key participants in securities violations.

Simply put, Peat Marwick's request that this Court use this case to unravel decades of sound law should be denied. As Congress has recognized, the existence of a private cause of action for aiding and abetting a violation of Section 10(b) of the Exchange Act comports with congressional intent as well as the letter and spirit of the statute itself.

II

THERE IS NO CONFLICT AMONG THE COURTS OF APPEALS AS TO THE PLEADING ISSUE RAISED BY THIS APPEAL

Peat Marwick attempts to conjure an issue for this Court's review by referring to an alleged conflict among certain circuit courts regarding the pleading issue decided by the Ninth Circuit in *Roberts*. As demonstrated below, there is no true conflict among the circuit courts. Accordingly, the petition for a writ of certiorari should be denied.

Initially, we note that the entire premise of Peat Marwick's argument respecting a circuit court "conflict" is dependent on the conclusion that this appeal involves an aiding and abetting claim against a participant in a securities transaction who is alleged to have done nothing more than remain silent in the face of its

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of 1988, wherein tippers were declared to be primary violators of Section 10(b), rather than aiders and abettors.

alleged knowledge of a fraud.[11] This contention is, of course, wrong. This case is not about silence or inaction or, stated another way, "whistleblower" liability. Peat Marwick is alleged to have rendered substantial assistance to a fraud by engaging in affirmative manipulative and deceptive conduct. Specifically, Peat Marwick is alleged to have participated in the preparation of false and misleading offering memoranda, to have agreed to be identified therein, and to have prepared false and misleading audit reports and tax forms relied on by limited partners in making cash contributions to the partnerships. Obviously, such conduct does not amount to "silence or inaction."

Numerous cases have held that assistance to a fraud involving a significantly lesser degree of involvement than that at issue here can give rise to aider and abettor liability. For example, in *Rolf v. Blyth, Eastman Dillon & Co.*, 570 F.2d 38 (2d Cir.), *cert. denied*, 439 U.S. 1039 (1978), the Second Circuit found that a broker rendered substantial assistance to a fraud by the ministerial acts of processing securities transactions directed by an investment advisor, reassuring the defrauded investor of the investment advisor's competence, and recklessly failing to learn of or disclose the fraud. *Id.* at 48.

In *Monsen v. Consolidated Dressed Beef Co., supra*, 579 F.2d 793, a bank was found to have aided and abetted a borrower's continuation of a promissory note sale program violating the registration and antifraud provisions of the federal securities laws, based solely on the bank's knowledge that the notes were unregistered, that the note buyers were receiving no financial information about the borrower, and that the borrower would not reveal to the note buyers its financial difficulties or the subordinated nature of the notes. *Id.* at 801-02. The Seventh Circuit in *SEC v. First Securities Co.*, 463 F.2d 981 (7th Cir.), *cert. denied*, 409 U.S. 880 (1972) held that a broker-dealer firm aided and abetted the creation and maintenance of a fraudulent escrow by its president,

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[11] The reason for this characterization is that it is only in cases where liability is based on "silence or inaction" that there is any discernible distinction among the circuit courts insofar as application of aiding and abetting principles are concerned.

because it provided him "with the trappings of a successful investment counsellor, held him out as providing such counsel, and then wilfully allowed the enforcement of a rule regarding the opening of mail which was antithetical to the prevention of frauds of the type which occurred." *Id.* at 988.

Aiding and abetting liability has also been imposed on a lawyer where he was present at the closing of a merger which he knew had been approved on the basis of misleading proxy materials. *SEC v. National Student Marketing Corp.*, 457 F.Supp. 682, 712-13 (D.D.C. 1978). *See also Anderson v. Francis I. DuPont & Co.*, 291 F.Supp. 705, 709 (D.Minn. 1968) (sufficiency of aiding and abetting allegation against broker dealers sustained based on their giving office space to an alleged primary violator, endorsing his skill, and holding him out as an important customer); *In re Gas Reclamation, Inc. Securities Litigation*, 659 F.Supp. 493, 504 (S.D.N.Y. 1987) (motion to dismiss denied where banks and insurance companies reviewed and approved private placement memorandum, devised marketing and financing scheme and engaged in atypical financing); *Index Fund, Inc. v. Hagopian*, 609 F.Supp. 499, 509 (S.D.N.Y. 1985) (summary judgment to defendant banks denied where banks allegedly failed to supervise primary violators and provided funds used by them); *Harmsen v. Smith*, 693 F.2d 932, 944-45 (9th Cir. 1982), *cert. denied*, 464 U.S. 822 (1983) (affirming jury verdict of aiding and abetting liability against the daughter of the principal architect of a fraudulent scheme and an officer and director of a conglomerate involved in the scheme); *Jett v. Sunderman*, 840 F.2d 1487, 1494 (9th Cir. 1988) (summary judgment in favor of an insurer reversed even in light of uncontroverted declaration that it was not involved in preparation of offering materials where evidence suggested it had knowledge of existence of a waiver in a bond which may have been material to decision to invest); *Renovitch v. Stewardship Concepts, Inc.*, 654 F.Supp. 353, 359 (N.D. Ill. 1987) (aiding and abetting claim upheld against attorneys where they either assisted in the preparation of and/or approved the statements made in allegedly false and misleading brochures used to sell securities); *Metge v. Baehler, supra*, 762 F.2d at 625-30 (bank's summary judgment motion denied where plaintiffs

claimed that bank knew issuer was selling worthless thrift certificates yet prolonged business of issuer by making atypical loans).

Clearly, numerous cases hold that conduct which does not even approach the level of Peat Marwick's participation as alleged in *Roberts* can give rise to aiding and abetting liability. Moreover, even accepting as true Peat Marwick's incorrect position that this case is about an alleged aider and abettor's silence or inaction, it is nonetheless clear that respondents' allegation against Peat Marwick states a claim for relief sufficient to withstand a motion to dismiss under Rule 12(b)(6), Fed.R.Civ.P.

The crux of Peat Marwick's argument is that a conflict exists among certain of the circuit courts regarding whether or not, in the context of a case involving silence or inaction on the part of the alleged aider and abettor, there must exist an *independent* duty to disclose—outside of the securities laws—before silence can give rise to liability. Petition for Certiorari at 9. Thus, it is contended that the decisions of the Seventh and Second Circuits in *Barker v. Henderson, Franklin, Starnes & Holt*, 797 F.2d 490 (7th Cir. 1986) and *IIT, An International Investment Trust v. Cornfeld, supra*, 619 F.2d 909, respectively, require that an "independent" pre-existing duty to act or disclose exist in order for aiding and abetting liability to be imposed, while the instant case and *Rudolph v. Arthur Andersen & Co.*, 800 F.2d 1040 (11th Cir. 1986, *rehearing en banc denied*, 806 F.2d 1070 (11th Cir. 1986), *cert. denied*, 480 U.S. 946 (1987), do not impose such a requirement.

To begin with, neither this case, nor the decision in *Rudolph*, involve silence or inaction. In both cases, accountants are either alleged to have participated in the preparation of false and misleading offering documents, or rendered audit reports on financial statements which were false when rendered, or which became false as a result of subsequent events. This contrasts sharply with the decision in *Barker*, where, as the Ninth Circuit noted, there was no evidence of any intent to deceive, that the defendants had even seen the selling documents, or that their

names were used therein. 857 F.2d at 653.[12] Likewise, in *IIT*, the Second Circuit recognized that liability may attach to an aider and abettor even in the absence of an independent duty to disclose if there is "clear evidence of the required degree of scienter . . . and a concious and specific motivation for not acting on the part of an entity with a direct involvement in the transaction." 619 F.2d at 927.

Thus, the Ninth Circuit's decision in *Roberts*, as well as *Rudolph*, fall within a well settled line of decisional authority which provides that aider and abettor liability may attach even where there may be no "independent" duty to disclose, if the evidence shows the requisite *scienter*. In these cases, the existence or non-existence of a duty relates solely to the degree of *scienter* required to find liability. This formulation provides ample protection to alleged aiders and abettors who may not have an "independent" duty to disclose, because they can only be found liable if they acted with the requisite *scienter*.[13] *See, e.g., Rudolph*, 800

[12] *Barker* was decided on a motion for summary judgment, after a full evidentiary record was assembled. Thus, apparently even the aiding and abetting allegation in *Barker* survived the pleading stage. This same problem arises with many of the decisions relied on by Peat Marwick, where allegations apparently survived the pleading stage, as the Ninth Circuit held should be the case here, but summary judgment was ultimately entered in favor of the defendant. *E.g., Bane v. Sigmundr Exploration Corp.*, 848 F.2d 579 (5th Cir. 1988) (summary judgment evidence did not support inference that bank sought to cloak principal defendants in aura of respectability or reliability); *Schlifke v. Seafirst Corp.*, 866 F.2d 935, 948 (7th Cir. 1989) (on summary judgment motion, plaintiffs failed to show that banks had any knowledge of, or acted recklessly, in failing to disclose fraudulent representations and omissions).

[13] All of this, of course, undermines Peat Marwick's argument that differing standards among the circuit courts insofar as aiding and abetting liability are concerned will give rise to forum shopping. To begin with, Peat Marwick is wrong in contending that, for example, the plaintiffs in *Latigo Ventures v. Laventhol & Horwath*, 876 F.2d 1322 (7th Cir. 1989) would have obtained a different result if their case was heard within the Ninth or Eleventh Circuits. Even the *Latigo Ventures* court recognized that the case before it was distinguishable from *Roberts*

F.2d at 1045; *Metge v. Baehler, supra*, 762 F.2d at 625; *SEC v. Washington County Util Dist.*, 676 F.2d 218, 226 (6th Cir. 1982); *Edwards & Hanly v. Wells Fargo Secs. Clearance Corp., supra*, 602 F.2d 478, 484-85 (2d Cir. 1979); *Gould v. American-Hawaiian S.S. Co.*, ~~535 F.2d~~ 761, 780 (3d Cir. 1976); *Woodward v. Metro Bank*, 522 F.2d 84, 97 (5th Cir. 1975); *Herm v. Stafford*, 663 F.2d 669, 684 (6th Cir. 1981); *Tucker v. Janota*, [1979 Transfer Binder] Fed.Sec.L.Rep. (CCH) ¶ 96,701 (N.D. Ill. Nov. 1, 1978).[14]

Where the requisite degree of *scienter* exists, coupled with substantial assistance, aider and abettor liability can properly be imposed. In such circumstances, participants who are aiders and abettors are not "insurers" of the primary violators' wrongdoing.[15]

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and *Rudolph* because there was no allegation of reliance on the auditors in making an investment decision. 876 F.2d at 1327. Moreover, the concerns respecting forum shopping ignore the venue provisions of the Exchange Act, 15 U.S.C. § 78aa, and the opportunity to move to change venue pursuant to 28 U.S.C. § 1404(a).

[14] The Ninth Circuit in *Roberts* recognized that a duty to disclose must exist. 857 F.2d at 653. Such a duty may arise based on the facts of the case. *Id.* This is in keeping with the established principle that whether or not a duty to disclose exists is a question of fact, dependent on the particular facts and circumstances of the case. *E.g., Spectrum Financial Companies v. Marconsult, Inc.*, 608 F.2d 377, 381 (9th Cir. 1979), *cert. denied*, 446 U.S. 936 (1980); *White v. Abrams*, 495 F.2d 724, 735-36 (9th Cir. 1974).

[15] Peat Marwick argues that several cases directly conflict with the Ninth Circuit's holding in *Roberts*. This is wrong. For example, as noted, the Seventh Circuit in *Latigo Ventures v. Laventhol & Horwath, supra*, 876 F.2d at 1327 specifically found that the case was distinguishable from *Roberts*. Similarly, in *LHLC v. Cluett, Peabody & Co.*, 842 F.2d 928 (7th Cir. 1988), *cert. denied*, ___ U.S. ___, 109 S.Ct. 311 (1988), the Seventh Circuit found that no claim was stated against an accounting firm because the document allegedly relied on by the defrauded investor was not seen until *after* the investment decision had been made and the transaction closed. *Id.* at 932. No such circumstance is presented here. Finally, in *Schneberger v. Wheeler*, 859 F.2d 1477 (11th Cir. 1988), *cert. denied*, ___ U.S. ___, 109 S.Ct. 2433 (1989), the court of appeals affirmed entry of summary judgment for a defendant

III

THE NINTH CIRCUIT'S DECISION DOES NOT CONFLICT WITH ANY DECISIONS OF THIS COURT

In support of its petition for a writ of certiorari, Peat Marwick contends that the Ninth Circuit's decision conflicts with the rationales of prior decisions of this Court. As we show, the cases relied on by Peat Marwick are inapposite.

The decision principally relied upon to support this argument is *United States v. Chiarella*, 445 U.S. 222 (1980). There, an employee of a financial printer was convicted of securities fraud based on his having used material non-public information purloined from documents given his employer to purchase stock in a target company, without disclosing his knowledge to the seller. This Court reversed the conviction, finding that Chiarella had no duty to disclose the information to the seller. Obviously, there are numerous material distinctions between *Chiarella* and the facts of this case.

Initially, it should be noted that in *Chiarella* the Supreme Court required that an independent duty to disclose must exist before nondisclosure becomes *a primary violation*. This does not address the situation of whether or not an independent duty to disclose must be found before aiding and abetting liability can be imposed. In any event, the *Chiarella* decision does not conflict with the case law which holds that, absent a duty to disclose, an aider and abettor can be liable if the requisite degree of *scienter* and substantial assistance is shown. Furthermore, the decision in *Chiarella* involved a *purchaser's* nondisclosure rather than, as here, nondisclosures by one of the world's largest accounting firms which was involved in the preparation of documents which it knew would be relied on by investors in making investment decisions. As stated in *Andreo v. Friedlander, Gaines, Cohen, Etc.*, 660 F.Supp. 1362 (D.Conn. 1987):

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bank because no evidence had been adduced that the bank had knowledge of a fraud. *Id.* at 1480-81. Significantly, the decision in *Schneberger* suggests that even if the bank had no independent duty to disclose, if there had been the requisite showing of *scienter*, aiding and abetting liability could properly be imposed. *Id.*

> While it is not reasonably foreseeable that a seller would rely on the disclosures of a purchaser (absent some special relationship), it is reasonably foreseeable that investors would rely on the expertise of the professionals that draft offering memoranda and tax opinions. As a result, such professionals should be under the obligation to not act in reckless disregard of the truth when they undertake the drafting of such documents.

Id. at 1368.

Numerous cases have noted the factually unique context in which *Chiarella* and a companion case, *Dirks v. SEC*, 463 U.S. 646 (1983), arose. For example, in *Deutschman v. Beneficial Corp.*, 841 F.2d 502 (3d Cir. 1988), the Third Circuit, in reversing dismissal of a class action securities fraud complaint, held that,

> The district court's reliance on *Chiarella* and *Dirks* is entirely misplaced. Those cases dealt not with injury caused by affirmative misrepresentations which affected the market price of securities, but with the analytically distinct problem of trading on undisclosed information; a theory of recovery which Deutschman does not plead. The 'disclose or abstain from trading' rule laid down in the insider trading cases imposes on insiders a duty to disclose information which need not otherwise be disclosed before they act on that information in any uninformed marketplace. Market participants who are neither insiders nor fiduciaries of another type need not disclose material facts, but can rely on the assumption that all other participants have equal access to information. *Chiarella* and *Dirks* involve only the question of when outsiders and nonfiduciaries will be treated as insiders or fiduciaries for purposes of the affirmative duty to disclose or refrain from trading. The court in those cases declined to extend the duty to disclose or abstain to mere tippees who came into possession of otherwise undislosed information. Nothing in those opinions, however, can be construed to require the existence of a fiduciary relationship between a section 10(b) defendant and the victim of that defendant's affirmative misrepresentation.

Id. at 506; *see also Abell v. Potomac Ins. Co.*, 858 F.2d 1104, 1125 n. 22 (5th Cir. 1988) (*Chiarella* and *Dirks* involved SEC charges of breach of a specialized duty); *United States v. Carpenter*, 791 F.2d 1024, 1029 (2d Cir. 1986), *aff'd*, ___ U.S. ___, 108 S.Ct. 316 (1987) ("[t]o give *Dirks* such preclusive effect would suggest that one application of a statute cannot admit of another application not raised in the first case").

There is nothing in the Ninth Circuit's decision in *Roberts* which conflicts with the holding of *Chiarella* and *Dirks*. When Peat Marwick participated in the preparation of the offering materials and agreed to allow its name to be used to sell securities, the investing public understood that Peat Marwick was vouching for the integrity of the offering, and reasonably assumed that the firm would not allow its name to be used to perpetrate a fraud. Likewise, when Peat Marwick issued audit reports on the partnerships' financial statements and prepared tax forms, the investing public could properly assume that, in the event a fraud was afoot, Peat Marwick would disclose it. As the Eleventh Circuit in *Rudolph* held, "[s]tanding idly by while knowing one's good name is being used to perpetrate a fraud is inherently misleading." 800 F.2d at 1044. For Peat Marwick to contend that its conduct in this case was not "communicative" misconstrues respondents' allegations and defies reality. Simply put, nothing in *Roberts* conflicts with this Court's prior decisions.

IV

PUBLIC POLICY CONSIDERATIONS SUPPORT DENIAL OF REVIEW

Peat Marwick advances several "public" policy considerations which it claims support review. These contentions should be viewed with a wary eye, however, since they are proffered on behalf of the accounting industry, not on behalf of the investing public, for whose benefit the federal securities laws were enacted in the first instance. Simply put, Peat Marwick's policy arguments are made in support of an unnecessarily restrictive view of the federal securities laws. Such arguments should be rejected.

Any discussion of the policy implications of a particular decision must start with consideration of the laws which were applied, their purpose, and how they have been interpreted. This Court has repeatedly recognized that the federal securities laws should be construed not technically and restrictively but flexibly to effectuate their broad remedial purposes. *E.g., Basic Inc. v. Levinson*, ___ U.S. ___, 108 S.Ct. 978, 982 (1988); *Herman & MacLean v. Huddleston, supra*, 459 U.S. at 386-87; *SEC v. Capital Gains Research Bureau*, 375 U.S. 180, 195 (1963); *Affiliated Ute Citizens of Utah v. United States*, 406 U.S. 128, 151 (1972), *reh'g denied*, 407 U.S. 916.

This principle is especially important today, when severe budget constraints have diminished the capability of the SEC to police the ever growing number of public and private securities offerings. The salutary goal of permitting a private plaintiff to pursue a securities fraud should, if anything, be encouraged in this environment.

Peat Marwick contends that the decision in *Roberts* departs from established principles of accountant liability. Traditionally, argues Peat Marwick, an accountant has only been held liable for what it represented in opinions on the financial statements of business entities. Peat Marwick goes on to suggest that the courts and investors understand that accountants only act through their reports and, therefore, the Ninth Circuit decision will somehow undermine this understanding. This is an Alice in Wonderland description of the accountant's role in today's business world. Accountants routinely and increasingly offer services other than conducting audits and preparing reports on financial statements. Indeed, the accounting profession now relies on non-auditing "consulting" and related services for a substantial part of its revenues. In agreeing to involve themselves in private securities offerings of the type at issue here, accountants undertake a responsibility to refrain from rendering critical assistance to a fraud on the investing public. That is especially true where, as here, not only did the accountant embroil itself in a securities offering by participating in the preparation of offering memoranda, but thereafter prepared reports on the issuer's financial statements.

This Court has previously described the accountant's role as one of "public watchdog." In *United States v. Arthur Young & Co.*, 465 U.S. 807 (1984), this Court stated:

> By certifying the public reports that collectively depict a corporation's financial status, the independent auditor assumes a *public* responsibility transcending any employment relationship with the client. The independent public accountant performing this special function owes ultimate allegiance to the corporation's creditors and stockholders, as well as to the investing public. This "public watchdog" function demands that the accountant maintain total independence from the client at all times and requires complete fidelity to the public trust.

Id. at 817-818 (emphasis in original).

The adverse consequences Peat Marwick alleges will arise if the Ninth Circuit's decision is allowed to stand ring hollow. Considerations such as the rising costs to accountants and their clients attributable to potential securities law liability pale in comparison to the damage—both monetary and psychological—to which the investing public is exposed in fraudulent securities schemes such as that in which Peat Marwick was involved. Moreover, the threat to creation of new business ventures which Peat Marwick claims the *Roberts* decision presents is a fiction. No empirical evidence whatsoever is offered to support the theory that increased exposure to securities law liability is harming the creation of new businesses. It is not too much to ask that professionals such as accountants, lawyers, and bankers decline to involve themselves in transactions where they know that a fraud is being committed. When they are involved in fraudulent schemes, they should not be immune to suit under the federal securities laws by investors who relied on their participation in making investments.

CONCLUSION

For the foregoing reasons, the Petition for a Writ of Certiorari filed in this case should be denied.

Dated: San Francisco, California
November 14, 1989

Respectfully submitted,

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(3)

No. 89-475

IN THE
Supreme Court of the United States
OCTOBER TERM, 1989

PEAT MARWICK MAIN & COMPANY,
Petitioner,
v.
PHILIP D. ROBERTS, *et al.*,
Respondents.

On Petition for a Writ of Certiorari to the
United States Court of Appeals for the Ninth Circuit

BRIEF OF LOMAS MORTGAGE U.S.A., INC.
AS *AMICUS CURIAE* IN SUPPORT OF PETITIONERS

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QUESTION PRESENTED

Amicus curiae will address the following question:

Whether a truthful statement that a professional services provider has agreed to perform future services contained in an allegedly misleading offering memorandum, coupled with a conclusory allegation that the professional services provider knew of alleged misstatements in the memorandum, creates a duty to disclose on the part of the professional services provider sufficient to render its silence as to the alleged misstatements actionable as aiding and abetting under Section 10(b) of the Securities Exchange Act of 1934 and Rule 10b-5 promulgated thereunder.

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BRIEF OF LOMAS MORTGAGE U.S.A., INC. AS *AMICUS CURIAE* IN SUPPORT OF PETITIONERS

INTEREST OF THE *AMICUS CURIAE*

Amicus curiae Lomas Mortgage U.S.A., Inc. ("Lomas") is recognized as a premier provider of mortgage servicing, with offices in several states and a mortgage servicing portfolio that extends nationwide.[1] For a national economy to function effectively, federal securities laws must be interpreted in a

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[1] Pursuant to Rule 36 of the Rules of this Court, the parties have consented to the filing of this brief. Petitioner's letter of consent has been filed with the Clerk of the Court. Respondents have granted verbal consent but were not able to supply written consent prior to this Brief's filing because of the earthquake in San Francisco. Pursuant to advice of the Clerk of the Court, Respondents' written consent will be filed with the Court immediately upon its receipt.

consistent manner. Lomas has, as a consequence of its nationwide presence, a keen interest in the uniform and reasoned development of the laws under which mortgage banking companies must operate. Because of this interest, Lomas brings to the Court's attention the substantial danger in which the decision below places reasoned development of the nation's securities laws.

In connection with a variety of financing transactions, including securities offerings, the underlying security for the capital raised is pooled mortgages. Whenever this is the case, a professional mortgage servicing company is needed to efficiently and effectively service the pool of mortgages. Lomas performs this service, and is described in offering documents as having agreed to provide such services in the future. If the decision below stands, Lomas and other mortgage servicing companies will be subject to the great expense of defending serious and costly litigation simply because such professional services providers are identified in allegedly fraudulent offering materials as agreeing to undertake mortgage servicing responsibilities. Participation by such companies may become impractical or require such drastically increased fees as to impair the feasibility of such transactions. Particularly in light of the proliferation of the security transaction as an important financing tool for governmental bodies as well as private concerns, the potential adverse impact of the decision below is highly significant.

Lomas's participation in this proceeding evidences the far-reaching practical impact of the decision below. Although the decision below dealt explicitly with accountants and attorneys, the opinion has dramatic effects on all professional services providers, including mortgage servicing companies, banks, geologists, private mortgage insurance companies and other companies providing various forms of insurance, and financial entities serving as trustees. Inconsistent standards among judicial circuits on the issues presented in this case could, as a

practical matter, impair innumerable commercial transactions. The purpose of this brief is to provide an understanding of the nature of the effects of the decision below on the national commercial marketplace and explain why, in the view of Lomas, the legal questions raised by the decision below are critical enough to warrant review by the Court.

STATEMENT

In this case, the United States Court of Appeals for the Ninth Circuit held that the truthful statement that a professional had agreed to provide services in the future contained in an allegedly misleading offering memorandum, combined with conclusory allegations that the firm knew of alleged misstatements in the memorandum, creates a duty to disclose on the part of the professional sufficient to make its silence actionable under Section 10(b) of the Securities Exchange Act of 1934 (the "Act"), 15 U.S.C. § 78j(b) (1982) ("Section 10(b)") and Rule 10b-5 of the Securities Exchange Commission (the "SEC"), 17 C.F.R. § 240.10b-5 (1988) ("Rule 10b-5"). *Roberts v. Peat Marwick Mitchell & Co.*, 857 F.2d 646 (9th Cir. 1988), *rev'g Roberts v. Heim*, 670 F. Supp. 1466 (N.D. Cal. 1987).

The allegedly fraudulent offering memorandum mentioned Peat Marwick only once, in an indisputably true statement that Peat Marwick "has agreed to perform accounting services for the Partnership, including the preparation of tax returns and audited financial statements." The complaint alleged that "the investors relied on Peat, Marwick's reputation when deciding to invest" and "they would not have invested had Peat, Marwick disclosed the alleged fraud." *Id.* at 653 (Pet. 15a). On that basis, the decision below stated:

> These facts may be sufficient to create a duty to disclose in Peat, Marwick. Investors can reasonably be expected to assume that an accounting firm would not consent to the

> use of its name on reports and offering memoranda it knew were fraudulent. Thus, it may be reasonable to expect an accountant to disclose fraud in this type of situation where the accountant's information is superior and the cost to the accountant of disclosure is minimal.

Id. at 653 (Pet. 14a). The Ninth Circuit also considered functionally parallel allegations concerning the conduct of another professional services provider, the law firm of Houston Harbaugh, which had rendered title opinions included within the offering memorandum. Unlike its opinion as to the accounting firm, the decision below affirmed summary judgment for the law firm:

> Unlike the allegations with respect to Peat, Marwick, no duty with respect to Houston Harbaugh could possibly be established by the facts alleged in the complaint . . . Even if the facts alleged are true, Houston Harbaugh's duty cannot extend to disclosing the information the investors wanted when it was hired only to determine marketability of title. Otherwise, a party could be liable for unlimited information even though it would be well beyond the matter for which it was retained.

Id. at 654 (Pet. 15a-16a). The decision below also affirmed, without discussion, the district court's dismissal of claims against technology consultants in enhanced oil recovery, on the basis that the "mere provision of information" and expertise to a primary violator in the absence of allegations explaining how the experts caused the fraud was insufficient to state a claim. *See Roberts*, 670 F. Supp. at 1483.

The Ninth Circuit denied a petition for rehearing and suggestion for rehearing *en banc* without opinion (Pet. 18a).

REASONS FOR GRANTING THE PETITION

The subject Petition presents issues that are extraordinarily ripe for this Court's review. Despite the total absence of an explicit basis for a private action for aiding and abetting under either Section 10(b) or Rule 10b-5, the Court's reservation of decision concerning whether such an action is permissible,[2] specific congressional intent against such implying such an action,[3] and adequate remedies against such behavior in criminal and administrative enforcement actions,[4] the lower

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[2] The Court has explicitly reserved decision on the questions of "whether civil liability for aiding and abetting is appropriate" and "the elements necessary to establish such a cause of action." *Ernst & Ernst v. Hochfelder*, 425 U.S. 185, 192 n.7 (1976); *see Herman & MacLean v. Huddleston*, 459 U.S. 375, 379 n.5 (1983).

[3] In 1959, Congress rejected a bill that would have made it unlawful for anyone to aid or abet a violation of the securities laws. *See* H.R. 2480, § 22, 86th Cong., 1st Sess. (1959), *reprinted in Securities Acts Amendments, 1959, Hearings Before a Subcomm. of the House Comm. on Interstate and Foreign Commerce on Securities Exchange Comm'n Matters*, 86th Cong., 1st Sess. 89, 93, 170 (1959). The SEC agreed that "no civil liability is intended." *SEC Legislation: Hearings Before a Subcomm. of the Senate Comm. on Banking and Currency on S. 1178, S. 1179, S. 1180, S. 1181, and S. 1182*, 86th Cong., 1st Sess. 288, 288, 370 (1959). In 1960, Congress again rejected aiding and abetting legislation. *See* S. 3770, § 20, 86th Cong., 2d Sess., 106 Cong. Rec. 15,613, 15,614 (1960); S. Rep. No. 1757, 86th Cong., 2d Sess. (1960).

[4] The SEC has authority to discipline brokers that aid or abet violations of the securities laws, *see* Act §§ 15(b)(4)(E), 15(b)(1), 15(b)(6) (allowing SEC to revoke registration of brokers), and to discipline investment advisors that aid or abet such violations, *see* Investments Advisers Act, §§ 203(e)(5) and § 209(e), 15 U.S.C. §§ 80b-3(e)(5), 80b-9(e) (1982 & Supp. V 1987). The SEC can deny the right to practice before the Commission to any attorney that has aided or abetted such a violation. *See* 17 C.F.R. § 201.2(e)(1)(iii), (3)(i) (1988). Title 18 of the federal criminal code also criminalizes aiding and abetting of securities violations. *See* 18 U.S.C. § 2(a) (1982), 15 U.S.C. §§ 78ff, 77x (1982 & Supp. V 1987).

federal courts have almost unanimously allowed such private actions under Section 10(b) and Rule 10b-5.[5] With the decision below, the lower courts' exercise in judicial legislation has finally gone awry. The Ninth Circuit has split from the majority by permitting a professional services provider to be held for trial on fraud charges conclusorily drawn from the single truthful disclosure that the professional would provide services to the issuer of securities in the future. The resultant disarray among the circuits, in combination with the flexibility in forum choice accorded plaintiffs in securities fraud actions,[6] threatens to undermine the commercial practicabilities underlying national securities offerings. For the reasons that follow, the Court should review the decision below.

I. The Decision Below Endangers A Consistent Nationwide Functioning Of Federal Securities Laws By Imposing Unprecedented Duties On Professional Services Providers

The federal securities laws present a balance between the goal of promoting equality of information among potential

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[5] Although *amicus* limits itself in this brief to the question of whether the conduct in this case can permissibly constitute aiding and abetting a securities violation, it agrees with Petitioner that the writ should also be granted to resolve the open question of whether aiding and abetting liability is permissible at all in a private action. *Accord*, Bromberg & Lowenfels, *Aiding and Abetting Securities Fraud: A Critical Examination*, 52 Albany L. Rev. 637, 773 (1988) (implied action should not be recognized); Fischel, *Secondary Liability Under Section 10(b) of the Securities Exchange Act of 1934*, 69 Calif. L. Rev. 80 (1981) (secondary liability is invalid); Ruder, *Multiple Defendants in Securities Fraud Cases: Aiding and Abetting, Conspiracy, in Pari Delicto, Indemnification and Contribution*, 120 U. Pa. L. Rev. 597, 646 (1972) (chairman of SEC arguing against such liability).

[6] Securities claims are, perhaps uniquely, subject to being instituted in "the widest possible choice of forums," *Somerville v. Major Exploration Inc.*, 576 F. Supp. 902, 908 (S.D.N.Y. 1983).

investors[7] and the equally important goal of not interfering with the "honest business" that permits a market in securities to exist.[8] The decision below endangers this delicate equilibrium by creating new and unprecedented duties of disclosure running from professional services providers to the investing public at large. By creating such duties, the decision below threatens to convert every professional whose conduct touches a securities offering into a guarantor for the fidelity of every aspect of that undertaking.

A modern securities offering cannot be accomplished without the assistance of scores of professional services providers. Accountants, attorneys, bankers, brokers, engineers, financial printers, geologists, lenders, mortgage servicing companies, and other professionals are necessary parties. The participation of such professionals can range from pervasive assistance in crafting the offering to a mere pledge to be available for the provision of services in the future. The latter role, while minimal in character, is absolutely essential to the

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[7] The "primary purpose of the Securities Exchange Act was to . . . provide fair and honest mechanisms for the pricing of securities [and] to assure that dealing in securities is fair and without undue preferences or advantages among the investors." *Radzanower v. Touche Ross & Co.*, 426 U.S. 148, 155 (1976); *see Securities Exchange Comm'n v. Capital Gains Research Bureau, Inc.*, 375 U.S. 180 (1963) (purpose is "to substitute a philosophy of full disclosure for the philosophy of caveat emptor and thus to achieve a high standard of business ethics in the securities industry").

[8] As stated by President Roosevelt, "[t]he purpose of the legislation, I suggest, is to protect the public with the least possible interference to honest business." S. Rep. No. 47, 73rd Cong., 1st Sess. 6-7 (1933). Concern for the welfare of business pervades the legislative history of the 1934 Act. *See* Note, *The Recognition of Aiding and Abetting in the Federal Securities Laws*, 23 Houston L. Rev. 821, 832 n.58 (1986). For example, Congressman Wolverton stated that Congress understood "the necessity of taking every precaution to preclude even the possibility of curing one evil by creating another or greater one" in avoiding legislation that "would adversely affect the business enterprises of our nation." 78 Cong. Rec. 7863 (1934).

operation of the national securities marketplace. Without assurance that a professional services provider will be available to provide future financial reports or service a pool of mortgages, for example, an offering would be entirely ineffectual.

Although such assurances of future services have become a commercial necessity, the decision below threatens to make provision of such assurances practically impossible or prohibitively expensive. The decision permits a plaintiff to make conclusory securities fraud allegations -- based wholly on speculation and surmise -- on the basis of a professional's pledge to provide future services. The decision below imposes a duty of disclosure running from the professional to all potential investors, reasoning that the professional would not permit its name to be mentioned had it not assured itself of the material truth of *all* aspects of the offering, whether in its realm of expertise or not. *See Roberts*, 857 F.2d at 653 (Pet. 14a). Under the decision below, two likely outcomes exist. First, professionals retained to perform future services will decline to be listed in any offering memoranda, thus *diminishing* the flow of information to the investing public rather than maximizing it, contrary to the goal of the securities laws. *Cf. supra* note 7. Second, professionals retained to perform specific and limited services in the future would be forced to undertake a due diligence investigation of all aspects of the offering -- not merely their expertised portion -- before consenting to the use of their names. This expanded duty, clearly required under *Roberts*, would require tremendous duplication of effort among the many professionals who must provide services to accomplish a securities offering. Accountants, bankers, and mortgage servicing companies, among others, would all be required to perform identically pervasive investigations of all aspects of the offering before permitting their names to be used in association with it. The enormous cost of such investigations would add substantially to the cost of all securities offerings.

The scope of the duty created by the decision below can be best understood by comparing the duty it seeks to impose on Peat Marwick to the established duty the common law imposes on accountants. It is established that an accounting firm has a "narrow duty of disclosure," *Pegasus Fund, Inc. v. Laraneta*, 617 F.2d 1335, 1340 (9th Cir. 1980), under which it has "no duty to see to correction of portions of the prospectus other than the financial statement it prepared." *IIT, an Int'l Inv. Trust v. Cornfeld*, 619 F.2d 909, 927 (2d Cir. 1980) (Friendly, J.). Even under more expansive theories of accountant duties to third parties, "the accountant does not become an insurer for every disappointed investor"[9] because an accountant's duties are limited to the application of accounting standards to the particular aspect of the offering for which the accountant was retained:[10]

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[9] Note, *Common Law Malpractice Liability of Accountants to Third Parties*, 44 Wash. & Lee L. Rev. 187, 209 (1987), *citing* American Institute of Certified Public Accountants, *Professional Standards* § 327.13 (1985). Even under those jurisdictions following the approach of the Restatement (Second) of Torts § 552 (1977), a professional only owes a duty of care to a third party if (1) the third party is among the limited class of people the professional intended to influence and (2) the type of transaction was such that the professional intended to influence third parties. Note, *supra*, at 190 n.16.

[10] An accountant does not guarantee that audited financial statements are correct, but assures investors that an audit conducted under generally accepted accounting principles and standards did not uncover any material errors. *See* American Institute of Certified Public Accountants, *Professional Standards* § 150 (1985); American Institute of Certified Public Accountants, *Auditing Standards* § 509.07 (1985). Although an independent accountant's function is to assure certainty in the investing process, *see United States v. Arthur Young & Co.*, 465 U.S. 805, 817-18 (1984), an accountant's role is limited by the accountant's lack of control over the client's records and bookkeeping processes. *See* Gormley, *The Foreseen, The Foreseeable, and Beyond -- Accountants' Liability to Nonclients*, 14 Seton Hall L. Rev. 528, 553 (1984).

It is not the law that whenever an accountant discovers that his client is in financial trouble he must blow the whistle on the client for the protection of investors -- so that [the defendant accounting firm] should have taken out an advertisement in the *Wall Street Journal* stating that [its client] was losing money, rather than waiting to report this in the next audit report. That would be an extreme theory of accountants' liability, and it is one we decline to embrace as an interpretation of the common law of Illinois . . .

Latigo Ventures v. Laventhol & Horwath, 876 F.2d 1322, 1327 (7th Cir. 1989). Even as a principal participant in the issuance of a prospectus under Section 11 of the Securities Act of 1933, an accountant would be responsible only for those portions of the prospectus subject to the accountant's expert review.[11] In stark contrast, under the decision below an accountant has a duty to investigate the material truth of all representations contained in an offering memorandum and, if any representation is materially false, has a further duty to inform the investing public of that falsity. *See Roberts*, 857 F.2d at 653 (Pet. 14a). Such a holding is tantamount to "implication of a duty to be one's brother's keeper, a duty unknown to common or federal securities law."[12] Such an advanced

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[11] *See Herman & MacLean v. Huddleston*, 459 U.S. 375, 381 (1983) ("Accountants are liable under Section 11 only for those matters which purport to have been prepared or certified by them"). Under the plain language of Section 11, "every accountant, engineer, or appraiser, or any person whose profession gives authority to a statement made by him, who has with his consent been named as having prepared or certified any part of the registration statement, or as having prepared or certified any report or valuation which is used in connection with the registration statement" is subject to suit "with respect to the statement in such registration statement, report, or valuation, which purports to have been prepared or certified by him[.]" 15 U.S.C. § 77k(a)(4) (1982).

[12] Branson, *Collateral Participant Liability Under the Securities Laws: Charting the Proper Course*, 65 Or. L. Rev. 327, 343 (1986); *see* Comment, *Lenders' Liability for Aiding and Abetting Rule 10b-5 Violations: The*

investigatory duty certainly has no place in federal securities law.

Contrary to decisions of this Court, the decision below implies an expansive duty directly from the securities laws rather than from a pre-existing independent duty owed by the accountant to the potential investor. This Court has insisted upon the presence of a duty independent of securities law before nondisclosure can constitute a violation of securities law. *See Chiarella v. United States*, 445 U.S. 222, 230 (1980) ("such liability is premised upon a duty to disclose arising from a relationship of trust and confidence between parties to a transaction"); *Dirks v. Securities Exchange Comm'n*, 463 U.S. 646, 653-54 (1983) (a "duty arises from the relationship between the parties"); *see also Basic, Inc. v. Levinson*, 108 S. Ct. 978, 987 n.17 (1988). The decision below, in contrast, derives a duty to disclose from alleged knowledge of the fraud itself, regardless of any independent duty. *See Roberts*, 857 F.2d at 653 (Pet. 14a). This derivation of a duty from the very law allegedly violated produces a "circular" result:

> When the nature of the offense is a failure to "blow the whistle," the defendant must have a *duty* to blow the whistle. And this duty does not come from § 10(b) or rule 10b-5; if it did the inquiry would be circular. The duty must come from a fiduciary relation outside securities law.

Schlifke v. Seafirst Corp., 866 F.2d 935, 948 (7th Cir. 1989), *quoting Barker v. Henderson, Franklin, Starnes & Holt*, 797 F.2d 490, 495-96 (7th Cir. 1986) (emphasis in original) (Easterbrook, J.). The duty imposed by the decision below, then, has no rational basis and cannot form the basis for imposition of liability.

Knowledge Standard, 41 Sw. L.J. 925, 941 (1987) ("Such a rule of law could devastate the commercial banking industry").

The imposition of the *Roberts* duty of investigation and disclosure is inconsistent with business realities accompanying the valid workings of the national securities marketplace. Imposition of this unprecedented duty on professional services providers will require such professionals to be held for trial on the basis of no more than a bare allegation based wholly on the mere mention of a professional's name in conjunction with provision of future services. The Court has recognized that:

> [L]itigation under Rule 10b-5 presents a danger of vexatiousness different in degree and in kind from that which accompanies litigation in general . . . even a complaint which by objective standards may have little chance of success at trial has a settlement value to the plaintiff out of proportion to its prospect of success at trial so long as he may prevent the suit from being resolved against him by dismissal or summary judgment.

Blue Chip Stamps v. Manor Drug Stores, 421 U.S. 723, 739-40 (1975); *see* Fischel, *supra* note 5, at 102 ("[e]ven if such a claim cannot be proved at trial, it may have significant settlement value"). The expansive new duties created by the decision below breed vexatious litigation for professionals engaged in ordinary business activity, with all the expense and complexities concomitant to that litigation. This Court should preserve the effective functioning of the national securities market by reviewing the decision below and correcting its improper imposition of unprecedented new duties on professional services providers.

II. The Decision Below Conflicts With Decisions Of Other Circuits, Making National Securities Offerings Difficult As A Practical Matter

For the national market in securities offerings to function effectively, securities laws must be interpreted with a high degree of uniformity.[13] As the Court has recognized, the securities laws must be interpreted to remove uncertainties and not in an *ad hoc* manner. *See Pinter v. Dahl,* 108 S. Ct. 2063, 2081 (1988); *see also Landreth Timber Co. v. Landreth,* 471 U.S. 681, 696 (1985). The decision below, and the Eleventh Circuit authority on which it relies, decimate a fragile uniformity that had developed among the lower courts concerning whether inaction can constitute "substantial assistance" to a primary securities violations without an independent pre-existing duty. The decision below creates a clear conflict between the Ninth and Eleventh Circuits and each other circuit considering the question, and even stands in conflict to the SEC itself. The Court should review the decision below to impose a uniform construction upon federal securities law and to protect those who participate in the

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[13] As commentators have pointed out, professionals participating in the securities market "must have some framework within which to pattern their actions. The theory of an effective marketplace assumes knowledge of the legal rules within which each individual must operate. A failure to define clearly these legal rules not only results in an inefficient marketplace but also allocates risks unfairly." Gilmore & McBride, *Liability of Financial Institutions for Aiding and Abetting Violations of Securities Laws,* 42 Wash. & Lee L. Rev. 811, 851 (1985). *See* A. Bromberg & L. Lowenfels, *Securities Fraud & Commodities Fraud,* § 8.5(615) at 8:520 (1988); *see also* Comment, *Lenders' Liability for Aiding and Abetting Rule 10b-5 Violations: The Knowledge Standard,* 41 Sw. L.J. 925, 941 (1987); Comment, *Lender Liability for Securities Law Violations of its Borrowers,* 38 Okla. L. Rev. 133, 136-42 (1985); Note, *Liability for Aiding and Abetting Violations of Rule 10b-5: The Recklessness Standard in Civil Damage Actions,* 62 Tex. L. Rev. 1087 (1987); Dooley, *The Effects of Civil Liability on Investment Banking and the New Issues Market,* 58 Va. L. Rev. 776 (1972).

national securities market from being subject to fragmented and varying duties among the various circuits.

The clarity of the conflict between the decision below and established precedent can be illustrated by a brief survey of recent opinions of the circuits and the SEC:

- The First Circuit has found that evidence showing that certain individuals had allowed their names to be listed in an allegedly fraudulent offering memorandum was insufficient to impose aider and abettor liability. *See Cleary v. Perfectune, Inc.*, 700 F.2d 774, 779 (1st Cir. 1983).

- The Second Circuit has determined that inaction can give rise to aider and abettor liability "only when there is a conscious or reckless violation of an independent duty to act" and has held that an accountant "had no independent duty to see to the correction of portions of the prospectus other than the financial statement it prepared." *See IIT, an Int'l Inv. Trust v. Cornfeld*, 619 F.2d 909, 927 (2d Cir. 1980).

- The Third Circuit has determined that the handling of stock purchases by brokers did not constitute "substantial assistance" of securities fraud even if the brokers had known that the purchases were effected to defraud third parties. *See Landy v. Federal Deposit Ins. Corp.*, 486 F.2d 139, 163 (3d Cir. 1973), *cert. denied*, 416 U.S. 960 (1974).

- The Fifth Circuit has recently held that no cause of action exists when a law firm acting as underwriters' counsel undertook a due diligence investigation, discovered fraud, and failed to disclose such fraud to investors. *See Abell v. Wright, Lindsey & Jennings*, 858 F.2d 1104 (5th Cir. 1988), *cert. denied in relevant part*, 109 S. Ct. 3242 (1989). The court also held that the law firm had not "assumed any duties to these bondholders merely by allowing its name to

be included in the final offering statement." *Id.* at 1122.[14]

- The Seventh Circuit has affirmed the dismissal of fraud claims against an accountant who not only lent his name to a memorandum but approved an allegedly fraudulent report. *See LHLC Corp. v. Cluett, Peabody & Co.*, 842 F.2d 928, 932-33 (7th Cir. 1988); *see also Schlifke v. Seafirst Corp.*, 866 F.2d 935, 947-48 (7th Cir. 1989).

- The Eighth Circuit has found that the involvement of an attorney rendering opinions on the legality of alleged sales of securities was "only tangential" and insufficient to state a claim. *See Stokes v. Lokken*, 644 F.2d 779, 784 (8th Cir. 1981).

- The Eleventh Circuit has held that a lender could not be held liable as an aider and abettor based on its failure to disclose its knowledge that the issuer was financially unsound. *See Schneberger v. Wheeler*, 859 F.2d 1477, 1480-81 (11th Cir. 1988), *cert. denied*, 109 S. Ct. 2433 (1989). *But cf. Rudolph v. Arthur Anderson & Co.*, 800 F.2d 1040 (11th Cir. 1986), *cert. denied*, 480 U.S. 946 (1987) (discussed below).

- The District of Columbia Circuit has held that an accounting firm mentioned in investment solicitation materials could not be subject to liability. *See Zoelsch v. Arthur Anderson & Co.*, 824 F.2d 27, 35-36 (D.C. Cir. 1987).

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[14] The Fifth Circuit has also held that no cause of action exists for aiding and abetting when a bank loaned funds to allegedly defrauded investors and authorized use of the bank's loan documents in investor packages. *See Bane v. Sigmundr Exploration Corp.*, 848 F.2d 579, 582 (5th Cir. 1988). The court held that the evidence "will not support an inference" that the bank "sought to cloak the principal defendants in an aura of respectability or reliability and thereby rendered knowing substantial assistance to the principals." *Id.*

- The SEC has held that a law firm could not be liable as an aider and abettor even though it had actually discovered fraud but failed to correct public misconceptions concerning its client. *See In re William R. Carter*, [1981 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 82,847, 84,166 (SEC Feb. 28, 1981).

The confusion among the lower courts is further illustrated by the vacillation exhibited by the Eleventh and Ninth Circuits. In the decision below, the Ninth Circuit relied upon *Rudolph v. Arthur Anderson & Co.*, 800 F.2d 1040 (11th Cir. 1986), *cert. denied*, 480 U.S. 946 (1987), in which the court found that aiding and abetting liability could be premised on an accountant's failure to disclose alleged fraud when the accountant allegedly permitted a prior accurate audit to appear in a placement memorandum even though it knew or should have known the memorandum contained unrelated misrepresentations. *See id.* at 1044-46. Two years later, however, the Eleventh Circuit determined -- in an opinion that did not mention *Rudolph* -- that a lender could *not* be held liable as an aider and abetter of a securities violation even though bank officers actually testified that the bank (1) knew its financing program would make the investment more attractive; (2) possessed the issuer's financial statements and knew the issuer had a \$14,000,000 working capital deficit; (3) knew that the issuer had been sued by an investor; and (4) had each specific investor sign a letter waiving any claims against the lender. *See Schneberger v. Wheeler*, 859 F.2d 1477, 1480 (11th Cir. 1988), *cert. denied*, 109 S. Ct. 2433 (1989). The rationale underlying the *Rudolph* decision and the *Schneberger* decision simply cannot be meshed. No doubt the Eleventh Circuit is in a state of internal conflict concerning the proper interpretation of "substantial assistance" in an implied action.

The Ninth Circuit is in no less a state of internal confusion. Although the decision below permits a finding of substantial assistance without a pre-existing independent duty to investigate and disclose, prior decisions of the Ninth Circuit permit no such liability. In *Strong v. France*, 474 F.2d 747 (9th Cir. 1973), and *Wessel v. Buhler*, 437 F.2d 279 (9th Cir. 1971), considerably greater conduct was undertaken by each professional services provider and no cause of action existed under either set of facts. In *Strong*, even though two defendants permitted their name and reputation to be used in solicitation of an offering -- and one defendant even confirmed the promoter's "unquestionable character and reliability" -- the Ninth Circuit found "no facts in this case which would impose any duty of disclosure." *Strong*, 474 F.2d at 752. In *Wessel*, an accountant took substantially more actions in support of an offering than did Peat Marwick in the case before the Court, yet the Ninth Circuit held that "there is not a scrap of authority supporting this extraordinary theory of Rule 10b-5 liability, and we will not supply any in this case." *Wessel*, 437 F.2d at 283. Indeed, the Ninth Circuit noted that "the exposure of independent accountants and others to such vistas of liability, limited only by the ingenuity of investors and their counsel, would lead to serious mischief." *Id.*

The "serious mischief" the Ninth Circuit predicted may be illustrated by the internally inconsistent adjudications within the decision below. First, a law firm that had actually performed past services was limited in its duty of disclosure to the narrow area of its expertise -- rendering title opinions. "Otherwise, a party could be liable for unlimited information even though it would be well beyond the matter for which it was retained." *Roberts*, 857 F.2d at 654 (Pet. 15a-16a). The decision below also affirmed, without any discussion, the district court's dismissal of technological consultants because the "mere provision of information" on which the allegedly fraudulent offering was based cannot support liability. *Roberts*, 670 F. Supp. at 1483. As to attorneys and consultants, the *Roberts*

duty appears to be limited to the area of expertise for which the professionals were retained. For accountants, however, the *Roberts* duty of investigation and public disclosure pervades every aspect of an offering. Such varying degrees of duty in a single opinion, without a word of discussion concerning why one professional merits a narrow duty and another professional merits a broad one, illustrates the unworkability of the *Roberts* analysis and underlines the importance of the Court accepting this case for review.

CONCLUSION

For the foregoing reasons, the petition for a writ of certiorari should be granted.

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October 23, 1989

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No. 89-475

IN THE

Supreme Court of the United States

OCTOBER TERM, 1989

PEAT MARWICK MAIN & CO.,
Petitioner,

v.

PHILIP D. ROBERTS, *et al.*,
Respondents.

On Petition for a Writ of Certiorari to the United States Court of Appeals for the Ninth Circuit

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BRIEF OF AMERICAN INSTITUTE OF CERTIFIED PUBLIC ACCOUNTANTS AS *AMICUS CURIAE* IN SUPPORT OF PETITIONER PEAT MARWICK MAIN & CO.

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QUESTIONS PRESENTED

The Institute fully supports each of the arguments made by Peat Marwick in its Petition and incorporates those arguments as if fully set forth herein. In the interest of brevity, this brief focuses on the issue that has in the past been specifically reserved by this Court and that is of overriding significance to the accounting profession, namely:

Whether there exists an implied private right of action for aiding and abetting a violation of Section 10(b) of the Securities Exchange Act of 1934 or Rule 10b-5 promulgated thereunder.

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BRIEF OF AMERICAN INSTITUTE OF CERTIFIED PUBLIC ACCOUNTANTS AS *AMICUS CURIAE* IN SUPPORT OF PETITIONER PEAT MARWICK MAIN & CO.

PRELIMINARY STATEMENT

The American Institute of Certified Public Accountants (the "Institute") submits this brief as *amicus curiae*, pursuant to Rule 36.1 of the Rules of this Court, in support of petitioner Peat Marwick Main & Co. ("Peat Marwick").[1]

INTEREST OF THE INSTITUTE AS *AMICUS CURIAE*

The Institute is the national organization of the certified public accounting profession, with more than 280,000 active members located in each of the fifty states. Among the Institute's objectives are the promotion and maintenance of accounting, auditing, and ethical standards of practice. As the authoritative source of these standards, the Institute has a profound interest in the scope and bases of civil liability sought to be imposed on accountants in connection with their professional services under the rubric of Section 10(b) of the Securities Exchange Act of 1934, 15 U.S.C. § 78j(b) (1988) ("Section 10(b)" and the "1934 Act") and Rule 10b-5, 17 C.F.R. § 240.10b-5 (1988) ("Rule 10b-5") promulgated thereunder.

The issues involved in this case transcend the interests of the parties and are of particular importance to the Institute and its members. The decision of the United States Court of Appeals for the Ninth Circuit establishes an extreme theory of accountants' liability for aiding and abetting violations of Section 10(b) and Rule 10b-5. Under the lower court's reasoning, the mere mention in an offering memorandum of an accounting firm's agreement to perform future services, together with a general

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[1] This brief is submitted on consent of the parties. The written consents of Petitioner and Respondents are being filed with the Clerk of the Court contemporaneously herewith.

averment of knowledge of material misstatements in the memorandum, may subject the firm to liability for aiding and abetting—even though the reference to the accounting firm is truthful and the firm has not otherwise made any statement or representation about the prospective investment. This holding demonstrates the uncontrolled expansion of secondary liability for accountants and other professional service providers that has occurred as the lower courts have struggled to apply common law concepts of aiding and abetting to securities fraud cases.

STATEMENT OF THE CASE

Petitioner, Peat Marwick, was one of over 100 defendants named in a class action complaint filed in the United States District Court for the Northern District of California. The plaintiff class is comprised of investors in thirty-nine oil and gas limited partnerships sold as potential tax shelters between 1979 and 1983 by three separate partnership groups (Complaint ¶ 12). When certain oil technologies that were purportedly crucial to the partnerships' success failed to materialize, the investors brought suit under Section 10(b) and Rule 10b-5, alleging fraud in the sale of the partnership interests. Plaintiffs claimed that the partnerships had failed to disclose, *inter alia*, material information about certain oil recovery technology in the memoranda used to sell the investments (Complaint ¶ 40).

Plaintiffs specifically charged Peat Marwick with primary violations of Section 10(b) on the basis of post-investment audit reports and tax forms it had prepared. They also charged Peat Marwick with aiding and abetting the partnerships' violations of Section 10(b) by "participating" in the preparation of the selling memoranda with "knowledge" of its falsity. The only fact claimed in support of this conclusory allegation was a single truthful statement contained in the offering documents that "Peat, Marwick, Mitchell & Co., Denver, Colorado has agreed to perform accounting services for the Partnership, includ-

ing the preparation of tax returns and audited financial statements" (Complaint ¶ 43(b)).

The district court granted summary judgment in favor of Peat Marwick on plaintiffs' Section 10(b) claim, finding that plaintiffs could not recover "based on financial reports issued after plaintiffs [had] purchased their units." *Roberts v. Heim*, 670 F. Supp. 1466, 1481 (N.D. Cal. 1987) (Pet. 40a). That court also dismissed plaintiffs' aiding and abetting claims against Peat Marwick with prejudice. After noting that the claim rested solely on the true statement that Peat Marwick would "provide accounting services in the future," the District Court refused to "expand the scope of § 10(b) liability to encompass professionals whose involvement in the perpetration of the alleged fraud was merely agreeing to provide professional services in the future." *Id.* at 1482 (Pet. 42a).

The Ninth Circuit affirmed summary judgment on plaintiffs' Section 10(b) claims. *Roberts v. Peat, Marwick, Mitchell & Co.*, 857 F.2d 646, 649-52 (9th Cir. 1988) (Pet. 8a-13a). It reversed dismissal of the aiding and abetting count, however, holding that the "investors have alleged that Peat, Marwick knew of the alleged violation but allowed the use of its name in offering memoranda despite that knowledge. These facts may be sufficient to create a duty to disclose in Peat, Marwick." *Id.* at 653 (Pet. 14a). The court explained its ruling as follows:

> Investors can reasonably be expected to assume that an accounting firm would not consent to the use of its name on reports and offering memoranda it knew were fraudulent. Thus, it may be reasonable to expect an accountant to disclose fraud in this type of situation, where the accountant's information is superior and the cost to the accountant of disclosure is minimal. [*Id.* (citations omitted) (Pet. 14a).]

SUMMARY OF ARGUMENT

This Court has repeatedly held, in various contexts, that the existence *vel non* of a statutory cause of action under Section 10(b), as well as its scope and elements, are a question of Congressional intent. The Ninth Circuit has simply ignored this precedent in its decision below, relying instead on common law concepts of aiding and abetting to impose expansive liability under the statute against accountants and other professionals. Such reliance is, in the words of this Court, "entirely misplaced." *Touche Ross & Co. v. Redington*, 442 U.S. 560, 568 (1979). Even a brief analysis of the language and legislative history of Section 10(b) strongly suggests that Congress never intended to expand the scope of liability under the statute to aiding and abetting, choosing instead to address such conduct through a number of express civil remedies.

Moreover, this Court has consistently rejected similar efforts to expand the scope of liability under Section 10(b) to conduct that is not itself proscribed by the statute. Most notably, this Court's holding in *Ernst & Ernst v. Hochfelder*, 425 U.S. 185 (1976), firmly established that the "manipulative or deceptive" language of Section 10(b) embraces intentional conduct only, thus requiring a showing of scienter on the part of the defendant. The decision below, in complete disregard of that limitation, expands the scope of liability to persons who have not engaged in a manipulative or deceptive practice within the meaning of Section 10(b). If permitted to stand, the lower court's decision portends an uncharted, potentially limitless, expansion of secondary liability under Section 10(b).

Finally, the Ninth Circuit and other lower courts have made no effort to consider or analyze the far-reaching impact that private actions for aiding and abetting are having on both the federal statutory disclosure scheme and on the availability and costs of accounting and other professional services. By requiring accountants and other

professionals to vouch for the accuracy of offering documents—even where the substance of those documents is beyond their expertise or control—the Ninth Circuit has encouraged investment decisions on the basis of an inferred endorsement, rather than a careful review of the comprehensive disclosures of management required under the federal securities laws. The Ninth Circuit's reasoning also permits the remotest of connections to an alleged fraud to be used by plaintiffs' counsel to ensnare accountants and other professionals in costly and vexatious litigation. The increasing costs and burdens of defense result in fewer and more expensive transactions, and disrupt the provision of accounting and other professional services to businesses, including new and speculative ventures that are vital to the growth of the economy.

The Petition of Peat Marwick provides this Court with the opportunity to resolve the important federal questions of law and policy posed by the existence *vel non* of an implied right of action for aiding and abetting under Section 10(b). The Ninth Circuit's decision, which expands the scope of actionable conduct under this court-made right to new extremes, demonstrates the risks of any further unguided jurisprudence on these issues.

ARGUMENT

THIS COURT SHOULD SETTLE THE IMPORTANT QUESTION OF WHETHER AN IMPLIED PRIVATE ACTION EXISTS FOR AIDING AND ABETTING VIOLATIONS OF SECTION 10(b) OF THE 1934 ACT AND RULE 10b-5 PROMULGATED THEREUNDER.

This Court is again called upon to define the permissible scope of implied private causes of action under Section 10(b) of the 1934 Act and Rule 10b-5 promulgated thereunder. The Petition of Peat Marwick provides this Court with an opportunity to address two significant questions of federal law that it has previously reserved: (1) "whether civil liability for aiding and abetting is appropriate" under Section 10(b) and Rule 10b-5; and (2) if so, "the elements necessary to establish

such a cause of action." *Ernst & Ernst*, 425 U.S. at 191-192 n.7; *see also Herman & MacLean v. Huddleston*, 459 U.S. 375, 376 n.5 (1983).

In the absence of a definitive ruling from this Court on these issues, federal trial and appellate courts have attempted to answer these important questions of federal statutory construction by an unprincipled application of concepts of aiding and abetting derived from the common law of torts and nowhere found in the statute. The result of this unguided effort has been a confused and unwarranted explosion of secondary liability under Section 10(b).[2]

A. Principles Of Statutory Construction Preclude The Imputation Of An Implied Right Of Action Where, As Here, It Is Inconsistent With The Statutory Text And Scheme.

The existence *vel non* of a statutory cause of action under Section 10(b), as well as its scope and elements, are a question of statutory construction. *See Touche Ross & Co. v. Redington*, 442 U.S. at 568. As emphasized by this Court, the " 'fact that a federal statute has been violated and some person harmed does not automatically give rise to a private cause of action in favor of that person.' " *Id.* at 568 (quoting *Cannon v. University of Chicago*, 441 U.S. 677, 688 (1979)). Rather, "[t]he ultimate question is one of congressional intent, not one of whether this Court thinks that it can improve upon the statutory scheme that Congress enacted into law." *Id.* at 578. In accordance with that injunction, this Court has refused to permit reliance on tort or common law principles as a justification for imputing private remedies: "[The] central inquiry [is] whether Congress intended to create, either expressly or by implication, a private cause of action." *Id.* at 575. *See also Transamerica Mortgage Advisors, Inc. v. Lewis*, 444

[2] An extensive discussion of the split of authority that has arisen among the Circuits on this issue is set forth in Peat Marwick's Petition at 13-19.

U.S. 11, 24 (1979) (the "dispositive question" is whether Congress intended to create a private cause of action).

While this Court has identified several factors in considering whether an implied private action exists under the federal securities laws,[3] the most critical and decisive issue is the legislative intent. *Touche Ross & Co. v. Redington*, 442 U.S. at 578.[4] Thus, any private right analysis necessarily begins with "the language and focus of the statute, its legislative history, and its purpose . . . ." *Id.* at 575-76. Where "the statute by its terms grants no private rights to any identifiable class . . . [and] the legislative history of the 1934 Act . . . does not speak to the issue . . . the inquiry ends there: The question whether Congress, either expressly or by implication, intended to create a private right of action, has been definitely answered in the negative." *Id.* at 576.

Despite this Court's clear instruction that legislative intent controls, the lower federal courts have made no effort to discern whether Congress intended to create an implied right of action for aiding and abetting under Section 10(b). *See* Fischel, *Secondary Liability Under Section 10(b) of the Securities Act of 1934*, 69 Calif. L. Rev. 80, 94 (1981) (lower courts have made "no attempt . . . to justify secondary liability by reference to the language of section 10(b), the statutory framework, or

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[3] The four criteria set forth in *Cort v. Ash*, 422 U.S. 66, 78 (1975), have been widely used in determining the existence *vel non* of an implied private action under the securities laws. While this brief does not permit a discussion of each of these factors (and, as noted hereinabove, a full analysis may not be necessary once Congressional intent has been discerned), the Institute is prepared to show that none of them supports a private action for aiding and abetting under Section 10(b).

[4] *See also Merrill Lynch, Pierce, Fenner & Smith, Inc. v. Curran*, 456 U.S. 353, 358 (1982) (no need to "trudge through all four of the factors when the dispositive question of legislative intent has been resolved"); *Transamerica Mortgage Advisors, Inc. v. Lewis*, 444 U.S. at 24 ("[t]he dispositive question remains whether Congress intended to create any such remedy").

relevant legislative history"). Rather, the courts have independently adopted common law concepts of aiding and abetting to support private actions under the statute.

Such reliance on unrelated common law to determine an issue cf Congressional intent is "entirely misplaced." *Touche Ross & Co. v. Redington*, 442 U.S. at 568. The Ninth Circuit's decision here provides the most recent and dramatic illustration of the lower courts' blind foray into this area of secondary liability. Without even a passing reference to the text of the 1934 Act, to the statutory framework or to Congressional intent, the court below has expanded the scope of liability under an implied right of action for aiding and abetting to reach conduct that is not proscribed by or otherwise actionable under Section 10(b). This result finds no warrant in either the language or legislative history of the statute.

1. *The Statutory Text And Scheme Do Not Support An Implied Right Of Action.*

Section 10(b) provides that "[i]t shall be unlawful for any person, directly or indirectly . . . [t]o use or employ, in connection with the purchase or sale of any security . . . any manipulative or deceptive device or contrivance . . . ." Neither the statute itself nor Rule 10b-5 contains any express provision making it unlawful to aid and abet violations of Section 10(b). The absence of any express statutory language for aiding and abetting "is strong evidence that Congress did not intend to impose such liability upon conduct which would not otherwise be prohibited as a 'manipulative or deceptive practice.'" Fischel, *Secondary Liability Under Section 10(b) of the Securities Act of 1934*, 69 Calif. L. Rev. at 95.

In contrast, Congress has provided explicit statutory authority for administrative and criminal enforcement actions against aiders and abettors in other provisions of the federal securities laws.[5] Moreover, Section 15 of the

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[5] For example, Section 15(b)(4)(E) of the 1934 Act authorizes the SEC to discipline a broker or dealer for aiding and abetting violations of the securities laws. Similarly, Sections 15(b)(1) and

1933 Act (15 U.S.C. § 77o (1988)) and Section 20(a) of the 1934 Act (15 U.S.C. § 78t (1988)) impose secondary liability on "controlling persons," provided they have not acted in good faith. Section 11 of the 1933 Act (15 U.S.C. § 77k (1988)) also imposes liability on, and grants defenses for, various nonprivity parties, such as accountants, underwriters, and other experts, for specified conduct relating to the preparation of registration statements; however, as to an accountant, this liability explicitly only extends to a statement which purports to have been "prepared or certified" by him, not to the remainder of the prospectus. Section 11(a)(4) (15 U.S.C. § 77k(a)(4) (1988)).

The express imposition of limited secondary liability under these provisions is highly significant in discerning Congressional intent: It demonstrates, in the words of this Court, that when Congress intended to impose such liability, "'it had little trouble doing so expressly.'" *Touche Ross & Co. v. Redington*, 442 U.S. at 572 (quoting *Blue Chip Stamps v. Manor Drug Stores*, 421 U.S. 723, 734 (1975)). Taken in conjunction with the fact that no express provision is made for private rights of action for aiding and abetting, a strong implication is raised that Congress knowingly and deliberately omitted such rights from the legislative scheme.

(b)(6) incorporate by reference all of Section 15(b)(4), thereby authorizing the SEC to deny registration to brokers or dealers who aid and abet violations, and to bar aiders and abettors from association with a broker or dealer. The SEC also has authority to discipline investment advisers and companies that aid and abet securities laws violations. *See* 15 U.S.C. §§ 80b-3(e)(5) (1988), 80a-9(b)(3) (1988), and 80b-9(d) (1988). SEC Rule of Practice 2(e), 17 C.F.R. § 201.2(e)(1)(iii), (3)(i) (1988), further authorizes the Commission to deny the right to practice before it to aiders and abettors.

2. *The Legislative History Of Section 10(b) Strongly Suggests That Congress Did Not Intend To Provide A Private Right Of Action Thereunder For Aiding And Abetting.*

The legislative history of Section 10(b) and other pertinent provisions of the 1934 Act reinforces the negative implication against private actions for aiding and abetting. There is no evidence in the legislative history of Section 10(b) that Congress ever intended to impose liability for aiding and abetting a primary violator. Moreover, in contrast to the subject of whether there is a private right of action for a primary violation of Section 10(b)—on which the legislative history is simply silent—the legislative history speaks clearly on the subject of secondary liability for aiding and abetting: Congress has specifically rejected attempts to amend the federal securities laws expressly to prohibit the aiding and abetting of violations of Section 10(b). In 1959, legislation was introduced that would have made it unlawful 'for any person to aid [or] abet . . . the violation of any provision of [the 1934 Act] or rule or regulation thereunder." [6] During deliberations on the amendment, industry representatives raised the expressed fear that it would result in aiders and abettors being liable for damages in private suits—prompting the SEC to agree to a clarification of the bill to indicate that "no civil liability is intended." [7] The bill, in any event, was never enacted. When language subjecting aiders and abettors to the SEC's injunctive powers was introduced the next year, it also failed.[8]

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[6] H.R. 5001 and S. 1178, 86th Cong., 1st Sess. (1959), reprinted in *Securities Acts Amendments, 1959: Hearings on H.R. 5001 Before a Subcomm. of the House Comm. on Interstate and Foreign Commerce*, 86th Cong., 1st Sess. 89, 103 (1959).

[7] *SEC Legislation: Hearings Before A Subcomm. of the Senate Comm. on Banking and Currency on S. 1178, S. 1179, S. 1180, S. 1181, and S. 1182*, 86th Cong., 1st Sess. 288, 292 (1959).

[8] *See* S. 3770, § 20, 86th Cong., 2d Sess., 106 Cong. Rec. 15,613, 15,614 (1960); S. Rep. No. 1757, 86th Cong., 2d Sess. (1960).

Moreover, Congress has successively amended Section 15(b)(4)(E) of the 1934 Act, which contains express enforcement provisions against aiders and abettors, without ever mentioning, much less adopting, any private rights of action. *See* 15 U.S.C. § 78o(b)(4)(E) (1988). This longstanding inaction, coupled with Congress's explicit rejection of efforts to amend the securities laws to include express private rights of action for aiding and abetting, appears to confirm that Congress has never intended to bring such conduct within the scope of the federal securities laws. *See Flood v. Kuhn*, 407 U.S. 258, 273-74 (1972) (Congress's repeated failure to amend antitrust laws to make them applicable to baseball indicates a Congressional intent that baseball remain exempt from those laws).

A summary review of the language and legislative history of Section 10(b), therefore, raises serious doubt that Congress intended to create private actions for aiding and abetting. Thus, while the Ninth Circuit and other lower federal courts have been quick to embrace such a right based on concepts borrowed from the common law of torts, the fundamental question of whether an implied private action for aiding and abetting exists under Section 10(b) has yet to be answered. The Petition of Peat Marwick provides this Court with an opportunity to address that important federal question and to provide much needed guidance to both the lower courts and to the investing public.

B. The Ninth Circuit Decision Conflicts With This Court's Repeated Efforts To Confine Liability Under Section 10(b) To Conduct Actually Proscribed By The Text Of The Statute.

The Ninth Circuit's adoption of common law concepts of aiding and abetting for use in the securities laws, besides lacking any apparent basis in congressional intent, directly conflicts with applicable decisions of this Court. While this Court has recognized an implied right of action for primary violations of Section 10(b), it has explicitly and repeatedly rejected any expansion of the

scope of actionable conduct beyond that statutorily proscribed by Congress.

In *Ernst & Ernst v. Hochfelder*, 425 U.S. 185 (1976), this Court reversed a finding by the Seventh Circuit that an accounting firm's negligent failure to uncover fraud on the part of the primary violator could subject it to liability as an aider and abettor. While reserving the question of whether an implied right of action for aiding and abetting exists under Section 10(b) (*id.* at 191-192 n.7), this Court held that the Seventh Circuit's decision constituted an unwarranted expansion of liability under the statute. Specifically, the Court found that the "manipulative or deceptive" language of Section 10(b) embraces intentional conduct only, thus requiring a showing of scienter on the part of the defendant. *Id.* at 200-202; 212.[9] While *Ernst & Ernst* does not explicitly deny the existence of an implied private action for aiding and abetting, therefore, it does hold—at a minimum—that a particular defendant's conduct is actionable only where it meets the test of "manipulative or deceptive."

This ruling casts serious doubt on the viability of implied private actions for aiding and abetting. As explained by one commentator:

> [U]nder a strict aiding and abetting analysis, it is irrelevant whether an aider and abettor has engaged in a manipulative or deceptive practice within the meaning of Section 10(b). What is relevant is

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[9] This Court's restrictive reading of the substantive scope of Section 10(b) has continued in *Santa Fe Indus., Inc. v. Green*, 430 U.S. 462, 473-74 (1977) (language of § 10(b) "gives no indication that Congress meant to prohibit any conduct . . . [that cannot] be fairly viewed as 'manipulative or deceptive' within the meaning of the statute"); *Chiarella v. United States*, 445 U.S. 222, 234-35 (1980) (The 1934 Act "cannot be read 'more broadly than its language and the statutory scheme reasonably permit.' [S]ection 10(b) is aptly described as a catchall provision, but what it catches must be fraud"); and *Herman & MacLean v. Huddleston*, 459 U.S. at 382 ("a § 10(b) plaintiff carries a heavier burden . . . [m]ost significantly, he must prove that the defendant acted with scienter, i.e., with intent to deceive, manipulate, or defraud").

> whether the *primary violator* engaged in such a practice. The critical inquiry then would be whether the secondary defendant aided and abetted in the commission of the violation.

Fischel, *Secondary Liability Under Section 10(b) of the Securities Act of 1934*, 69 Calif. L. Rev. at 88 (emphasis in original). By refusing to extend liability to the accounting firm because it had not engaged in a "manipulative or deceptive" practice, and by not separately considering whether an independent claim could be made against the firm for aiding and abetting, the decision in *Ernst & Ernst* suggests that aiding and abetting liability does not exist under Section 10(b); or, at the very least, that such liability extends only to conduct that is itself an express violation of the provision.[10]

In adopting common law concepts of aiding and abetting for use in Section 10(b) cases, however, the lower federal courts have largely ignored the "manipulative or deceptive" limitation required by the statute and this Court. The Ninth Circuit's decision here not only ignores this limitation, but directly contradicts it: The lower court expressly held that the respondents could *not* state a claim for a primary violation against Peat Marwick on the facts of the case. Thus, there is no allegation re-

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[10] At least one district court has read the *Ernst & Ernst* decision implicitly to hold that there is no private right of action for aiding and abetting:

> It is . . . doubtful that a claim for "aiding and abetting" or "conspiracy" will continue to exist under 10(b). The Court did not reach this issue in *Ernst*, but its statement that intent is necessary to state a claim under 10(b) implicitly holds that aiding and abetting liability will not exist apart from liability for a direct violation. Recent commentary supports this view. This is also further supported by decisions which hold that liability under 10(b) is solely a question of Congressional intent. Reliance on tort law principles for implying a right of action under the Securities Act is "entirely misplaced."

Benoay v. Decker, 517 F. Supp. 490, 495 (E.D. Mich. 1981), *aff'd without published opinion*, 735 F.2d 1363 (6th Cir. 1984) (citations omitted).

maintaining that Peat Marwick itself engaged in a manipulative or deceptive act, as required under the principle of law stated in *Ernst & Ernst.* The Ninth Circuit concluded, nonetheless, that Peat Marwick might be proven liable as an aider and abettor, declaring—without legal authority or statutory analysis—that "[a]iding and abetting is itself a violation of Section 10(b) and Rule 10b-5." *Roberts v. Peat, Marwick, Mitchell & Co.*, 857 F.2d at 653 (Pet. 14a).

In short, the lower court has reached the same result that this Court rejected in *Ernst & Ernst*; namely, it has adopted a rule of law that imposes liability for conduct that does not itself satisfy the statutorily derived elements of a primary violation. Those elements were carefully drawn by Congress in measuring the scope of liability under Section 10(b), and this Court has faithfully adhered to them in defining the contours of private actions brought under the statute. Having now freed an implied right of action for aiding and abetting from these statutory moorings, the Ninth Circuit's decision portends an uncharted, potentially limitless, expansion of secondary liability under Section 10(b). The risks of such unguided potential liability compel the attention of this Court.

C. Recognition Of Implied Private Actions For Aiding And Abetting Imposes Unlimited Potential Liability And Will Disrupt The Provision Of Accounting And Other Professional Services To The Public.

Finally, the Ninth Circuit's recognition of an implied private action for aiding and abetting poses serious policy considerations that have never been addressed by this Court. While only a brief discussion of those issues is permitted here, the Institute is prepared to show that the existence of such an implied right subverts elemental principles of the federal securities laws and allows imposition of the sort of speculative liability that this Court has previously condemned. The potential consequences of such an extension of secondary liability on professional

service providers are profoundly disturbing and demonstrate that such a rule is improvident.

1. ***An Implied Private Action For Aiding And Abetting Undermines The Federal Statutory Disclosure Scheme.***

The 1933 Act was designed, *inter alia*, "to provide investors with full disclosure of material information concerning public offerings of securities . . . ." *Ernst & Ernst v. Hochfelder*, 425 U.S. at 195 (citations omitted). The federal statutory disclosure scheme is premised on the principle that management is in the best position to make full disclosure of material facts regarding its business operations. This principle is reflected in the express remedies created by Congress under the Act, which impose virtually absolute liability against the issuer of a security, while creating higher standards of liability and defenses for other enumerated parties, including accountants, who have only assisted in the preparation of certain portions of a registration statement. *See* 15 U.S.C. § 77k(b) (1988). Recognition of broad secondary liability under Section 10(b) subverts this Congressional calculus by permitting management to shift liability to its accountants, underwriters, and other professional service providers, thereby reducing management's incentive to make full and accurate disclosure. Schy, *Privity and Accountants' Liability*, 16 Sec. Reg. L. J. 54, 63 (1988).

The Ninth Circuit's decision here offers further evidence of how increasingly expansive secondary liability under Section 10(b) undermines the federal statutory disclosure scheme. The lower court's assumption that an accounting firm "would not consent to the use of its name" on false reports elevates status over conduct in a manner that is both confusing to the investing public and unfair to professionals. First, this assumption completely disregards the role and purpose of an accountant. Certified Public Accountants are typically engaged to audit and report on the financial statements of a company through the application of detailed rules and stand-

ards, many of which were developed by the Institute. The investing public relies on auditors to review and report on financial statements consistent with these professional standards. It should not expect accountants to render reports on aspects of a company's business that they were not retained to review and over which they may have neither the expertise nor the access to information necessary to form a valid opinion. Thus, the Ninth Circuit's presumption that the plaintiffs here could have reasonably relied upon Peat Marwick, at a time before it had performed any services or issued any report, to discover, evaluate, and disclose the partnerships' alleged misrepresentations about certain oil recovery technology is entirely unreasonable.

Second, this type of presumption wrongly suggests to investors that they may disregard the substance of offering documents and rely on the mere mention of a reputable accounting firm or other professional organization in offering documents as proof-positive that the investment is sound. By encouraging investment decisions on the basis of an inferred endorsement, rather than a careful review of actual disclosures, the Ninth Circuit's decision effectively supplants the purpose and operation of the federal securities disclosure laws.

2. *The Drastic Expansion Of Secondary Liability Threatens To Disrupt The Provision Of Accounting And Other Professional Services.*

The unguided adoption of aiding and abetting liability under Section 10(b) by the lower federal courts has significantly broadened the number of cases where plaintiffs may seek to impose liability on accountants and other experts. The federal reporters increasingly abound with cases in which accountants have been required to defend against claims of aiding and abetting a violation of Section 10(b) through costly discovery or trial.[11] These re-

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[11] Those cases include the following: *Barker v. Henderson, Franklin, Starnes & Holt*, 797 F.2d 490 (7th Cir. 1986); *Sirota v. Solitron Devices, Inc.*, 673 F.2d 566 (2d Cir.), *cert. denied*, 459

ported cases are, of course, only the visible tip of a much larger bulk of cases working their way through the courts. This flood of cases can be expected to swell significantly under the Ninth Circuit's decision, which signals to plaintiffs' counsel that even the remotest connection to an alleged fraud may be sufficient to draw accountants and other "deep pocket" service providers into burdensome litigation. Moreover, by effectively precluding dismissal under Fed. R. Civ. P. 12(b) in cases where some "knowledge" of the alleged fraud is averred, the ruling will greatly increase the costs of defense for accountants and other professionals, who will be required to defend against conclusory allegations of aiding and abetting at least through the discovery and summary judgment phases of the litigation.[12]

U.S. 838, *cert. denied*, 459 U.S. 908 (1982); *Rosen v. Dick*, 639 F.2d 82 (2d Cir. 1980); *National Union Fire Ins. Co. v. Cooper*, [1989 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 94,452 (S.D.N.Y. April 18, 1989); *TCF Banking and Sav., F.A. v. Arthur Young & Co.*, 706 F. Supp. 1408 (D. Minn. 1988); *Bernstein v. Crazy Eddie, Inc.*, 702 F. Supp. 962 (E.D.N.Y. 1988); *In re Union Carbide Corp. Consumer Prods. Business Sec. Litig.*, 676 F. Supp. 458 (S.D.N.Y. 1987); *In re Storage Technology Corp. Sec. Litig.*, 630 F. Supp. 1072 (D. Colo. 1986); *Ahern v. Gaussoin*, 611 F. Supp. 1465 (D. Or. 1985); *Lewis v. Berry*, 101 F.R.D. 706 (W.D. Wash. 1984); *Summer v. Land & Leisure, Inc.*, 571 F. Supp. 380 (S.D. Fla. 1983); *Zatkin v. Primuth*, 551 F. Supp. 39 (S.D. Cal. 1982); *Fund of Funds, Ltd. v. Arthur Andersen & Co.*, 545 F. Supp. 1314 (S.D.N.Y. 1982); *Seiffer v. Topsy's Int'l, Inc.*, 487 F. Supp. 653 (D. Kan. 1980).

[12] For example, the Ninth Circuit's rule would have likely precluded the granting of motions to dismiss in favor of defendant accounting firms in the following cases: *Latigo Ventures v. Laventhol & Horwath*, 876 F.2d 1322 (7th Cir. 1989) (where accountants performed audit and allegedly removed ominous qualification that financial results reported were subject to company's continuation as going concern); *Zoelsch v. Arthur Andersen & Co.*, 824 F.2d 27 (D.C. Cir. 1987) (where American accounting firm supplied allegedly false information used by West German accounting firm in draft of audit report); *Oleck v. Fischer*, 623 F.2d 791 (2d Cir. 1980) (where accountants certified financial statements which plaintiff alleged gave false impressions through its descriptive lan-

Thus, the Ninth Circuit's conclusion that broad secondary liability is warranted here because "the cost to the accountant of disclosure is minimal" focuses on the wrong issue. *Roberts v. Peat, Marwick, Mitchell & Co.*, 857 F.2d at 653 (Pet. 14a)). It is not the costs of disclosure that threaten to disrupt accounting and other professional services. Rather, it is the enormous liability costs resulting from the lower courts' increasing willingness to shift the responsibilities of disclosure away from management and onto the shoulders of accountants and other professionals. As demonstrated by the present case, that responsibility may be imposed regardless of the level of involvement or control that the professionals might reasonably be expected to exercise over the substance of the disclosures.

Given this expansive threat of liability, the costs of defense have become a significant part of the fees accountants must charge for their services. This cost, in essence, is a form of required insurance against the risk of the deal itself, and not against any conduct on the part of the accountant. The costs of professional insurance have also skyrocketed, requiring an increasing number of firms to self-insure or "go bare." As recently explained by one observer:

> Malpractice premiums have been rising, policy limits have been falling, and deductibles have been increasing. Some accountants have chosen to go bare, and

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guage); *Stevens v. Equidyne Extractive Indus., 1980 Petro/Coal Program 1*, 694 F. Supp. 1057 (S.D.N.Y. 1988) (where accountant's involvement was limited to issuance of pro forma projections and accountant did not issue opinion letter); *In re Gas Reclamation, Inc. Sec. Litig.*, 659 F. Supp. 493 (S.D.N.Y. 1987) (where accountants mailed two engagement letters to company and promised to provide future consulting and auditing services); *In re AM Int'l, Inc. Sec. Litig.*, 606 F. Supp. 600 (S.D.N.Y. 1985) (where accountants provided interim financial reports); *Beissinger v. Rockwood Computer Corp.*, 529 F. Supp. 770 (E.D. Pa. 1981) (where accountants certified without qualification financial statements which were used by company to prepare annual report which contained misstatements).

some insurers have refused to write coverage for accountants perceived as high risks.

Goldberg, "*Accountable Accountants: Is Third-Party Liability Necessary?*" 17 J. Legal Stud. 295, 295-296 (1988) (footnotes omitted). The defense and insurance costs of other professional services have similarly increased.

The effect of these higher costs on the economy are predictable: transactions requiring accounting services become more expensive and inevitably fewer. Accountants therefore find it less desirable to serve clients with new or untested business ideas. New ventures or ventures in speculative industries will find it increasingly difficult and costly to retain accountants. As a result, entrepreneurial ventures, including experimental or high-technology companies that are vital to the growth of the economy, may be impeded. *See* Minow, *Accountants' Liability and the Litigation Explosion*, 156 J. Acct. 80 (Sept. 1984).

3. ***Permitting Private Actions For Aiding And Abetting Will Burden The Courts And Subject Accountants And Other Professionals To Abusive Litigation.***

Finally, the Ninth Circuit's decision underscores the vulnerability of accountants and other professionals to vexatious litigation. If the ruling is permitted to stand, Peat Marwick will be forced to incur the costs and burdens of defending itself, at least through the summary judgment stage, on the basis of plaintiffs' boilerplate, one-line averment that it "knew" the offering memoranda were false. As knowledge may always be averred generally, the lower court's decision arms plaintiffs with the *in terrorem* weapon of a securities class action against professionals, such as Peat Marwick, who are often assumed to have the "deep pockets" necessary to afford recovery—regardless of the degree of their culpability, if any, in the alleged fraud. This Court cautioned against just such a result in *Blue Chip Stamps v. Manor Drug Stores*, 421 U.S. at 741:

> [T]o the extent that [this process] permits a plaintiff with a largely groundless claim to simply take up the time of a number of other people, with the right to do so representing an *in terrorem* increment of the settlement value, rather than a reasonably founded hope that the process will reveal relevant evidence, it is a social cost rather than a benefit.

The prospect of class action strike suits poses a particular threat when brought, as here, under Section 10(b), which lacks the procedural restrictions, such as an abbreviated statute of limitations and an allowance for the recovery of attorney's fees, provided for by Sections 9(e) and 18(a) of the 1934 Act.

The court below disregarded these concerns by adopting an expansive rule of secondary liability. The consequences of the Ninth Circuit's decision must be assessed not only in the isolated circumstances of this case, but in terms of all the cases to come. As noted in *Ernst & Ernst*:

> The class of persons eligible to benefit from such a standard, though small in this case, could be numbered in the thousands in other cases . . . . [W]e are not the first court to express concern that the inexorable broadening of the class of plaintiff who may sue in this area of the law will ultimately result in more harm than good.

425 U.S. at 214-216 n.33. Here, as there, "[a]cceptance of respondents' view would extend to new frontiers the 'hazards' of rendering expert advice under the [Securities] Acts, raising serious policy questions not yet addressed by Congress." *Id.* The decision below should be reviewed by this Court to ensure that the Congressional judgment as to the appropriate scope of liability under Section 10(b) and Rule 10b-5 is not supplanted to expose professionals to broad secondary liability under the 1934 Act that was never contemplated by Congress.

CONCLUSION

For the foregoing reasons, the Petition of Peat Marwick should be granted.

Respectfully submitted,

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(5)

No. 89-475

IN THE

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OCTOBER TERM, 1989

PEAT MARWICK MAIN & CO.,

Petitioner,

—v.—

PHILIP D. ROBERTS, et al.,

Respondents.

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE NINTH CIRCUIT

REPLY BRIEF IN FURTHER SUPPORT OF PETITION

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Reference is made to Peat Marwick's statement pursuant to Rule 28.1 at page ii of the Petition for a Writ of Certiorari ("Pet.").

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REPLY BRIEF IN FURTHER SUPPORT OF PETITION

This reply brief responds to the principal new arguments advanced by respondents in the brief in opposition ("Br. Op.").

The Ninth Circuit's Treatment of Section 10(b) Aiding and Abetting Liability Premised on Silence or Inaction Conflicts With Decisions of Other Circuit Courts and Principles Announced By This Court in *Dirks* v. *SEC* and *Chiarella* v. *United States*.

(1) Respondents assert that "There Is No Conflict Among The Courts Of Appeals As To The Pleading Issue Raised By This Appeal" (Br. Op. 13). But respondents can support that proposition only by redefining, in a fashion flatly at variance with the Ninth Circuit, the matter at issue here: aiding and abetting claims premised on a defendant's silence or inaction.

(a) Respondents' central thrust is *not* that conflict is lacking among the circuits on the issue of aiding and abetting liability premised on silence or inaction. (Indeed, the brief in opposition at one point concedes that with respect to "silence or inaction" there *is* a "discernible distinction among the circuit courts insofar as application of aiding and abetting principles are concerned" (Br. Op. 14, n.11).)

Rather, their principal argument is that this case does not involve a claim premised on silence or inaction at all (Br. Op. 4, 7-8, 14, 16). (*E.g.*, "This case is not about silence or inaction or, stated another way, 'whistleblower' liability" (Br. Op. 14).) Yet that is precisely the issue which the Ninth Circuit understood the complaint to raise and which its opinion addressed. ("Defendants may be liable for aiding and abetting *based on their silence* if they have a duty to disclose knowledge that would be material to investors." 857 F.2d at 652-53 (Pet. 14a) (emphasis added).) Thus, even while reading the Fourth Amended Complaint far more expansively than did the district court, *compare* 670 F. Supp. at 1482 (Pet. 41a-42a) *with* 857 F.2d at 652 (Pet. 13a), the court of appeals recognized that it was silence or inaction, not affirmative conduct, as respondents would now have it, that was at issue.[1]

Nor can the fact that in this case potential liability is premised on silence be avoided by reference to the reports on financial statements and tax returns that Peat Marwick did eventually prepare (Br. Op. 4-5 & n.4, 14). Both the district court and the

1 The court of appeals adopted its characterization of the claim as one predicated on "silence" *after* setting forth its gloss on the allegations of the complaint cited at page 7 of the Petition (and at page 3 of the Br. Op.). As this fact itself suggests, the allegations of the complaint as to "participation" in the preparation and "effective control" of the offering memoranda and "investigation" in connection therewith simply reduce themselves to the core allegation that Peat Marwick permitted use of its name while allegedly knowing of a fraud. The court refers to no allegation that Peat Marwick actively participated in any fraud, or authored any false report, only that it permitted use of its name and hence its reputation without disclosing its alleged knowledge of fraud. 857 F.2d at 653 (Pet. 14a-15a). The court of appeals held that this silence was itself actionable.

Ninth Circuit held in the context of primary liability and based on respondents' own "acknowledge[ment]" as to the timing of the preparation and dissemination of these reports, 857 F.2d at 649 (Pet. 7a), that these allegations were legally irrelevant. 857 F.2d at 652 (Pet. 12a-13a); 670 F. Supp. at 1481 (Pet. 40a). The court noted those allegations in listing the facts in the complaint, 857 F.2d at 652 (Pet. 13a), but did not rely on them in explaining its reasons for sustaining the aiding and abetting claim. 857 F.2d at 652-53 (Pet. 14a-15a). They remain without legal effect. The claim at issue is, as the Ninth Circuit recognized, one premised on Peat Marwick's silence.

(b) Although respondents repeatedly promise to explain their somewhat muted contention that no conflict among the circuits exists even as to the standards to be applied on the issue of silence or inaction (*see*, *e.g.*, Br. Op. 13, 16), no such explanation is offered. The Petition for Certiorari cites cases from both the Second and Seventh Circuits in conflict with the decision of the Ninth Circuit on this issue. Respondents seek to portray the *Roberts* decision as simply part of a "well settled line of decisional authority" holding that aider and abettor liability may attach even absent an independent duty to disclose if the evidence shows the requisite scienter (Br. Op. 17). The decisions of the Second and Seventh Circuits simply cannot be reconciled with this approach, however.

Respondents offer the suggestion that the Second Circuit's decision in *IIT* v. *Cornfeld*, 619 F.2d 909 (2d Cir. 1980), holds that the presence of scienter avoids any need to find an independent duty in such cases (Br. Op. 16-17). The very language quoted by respondents makes clear, however, that only the existence of such independent duty or clear evidence of both scienter "*and* a conscious and specific motivation for not acting on the part of an entity with a direct involvement in the transaction" is required. 619 F.2d at 927 (emphasis added). Respondents do not account for these additional requirements, requirements plainly not met by the pleading here nor required by the Ninth Circuit decision as to which review is sought. Respondents offer even less by way of avoiding the differences between the Seventh Circuit approach and that followed here,

suggesting only a series of irrelevant factual distinctions which do not negate the fundamentally different nature of the Seventh and Ninth Circuits' legal analyses described in the Petition (Pet. 13-16).

(2) Respondents seek to avoid the conflict in approach between the Ninth Circuit's *Roberts* decision and this Court's rulings in *Dirks* v. *SEC*, 463 U.S. 646 (1983), and *Chiarella* v. *United States*, 445 U.S. 222 (1980), by reference to the fact that this Court's decisions in those cases concerned insider trading and involved primary as opposed to secondary liability (Br. Op. 19-20). But these factual distinctions hardly alter or make less instructive this Court's recognition in those decisions that only the existence of a duty to disclose can render non-disclosure actionable. Certainly the lower courts have read *Dirks* and *Chiarella* as providing direct guidance in cases asserting secondary liability outside the insider trading context. *See Schlifke* v. *Seafirst Corp.*, 866 F.2d 935, 947-48 (7th Cir. 1987); *Barker* v. *Henderson, Franklin, Starnes & Holt*, 797 F.2d 490, 495-96 (7th Cir. 1986); *Cairns* v. *Renneisen, Renneisen & Redfield*, [1987] Fed. Sec. L. Rep. (CCH) ¶ 93,626 at 97,839 (E.D. Pa. 1987).

Respondents also purport to distinguish the *Dirks* and *Chiarella* duty discussion on the bases set forth in *Deutschman* v. *Beneficial Corp.*, 841 F.2d 502 (3d Cir. 1988), *cert. denied*, 109 S.Ct. 3176 (1989), a decision they quote at length (Br. Op. 20-21). But *Deutschman's* holding that *Dirks* and *Chiarella* were inapplicable was premised, as the last sentence of *Deutschman* quoted by respondents reflects, on a situation involving "affirmative misrepresentation", not a failure to disclose. The sentence immediately following, not quoted by respondents, makes the point even more plainly: "Except to the extent that other federal statutes may have imposed a disclosure obligation . . . , [defendant] and its officers *were free to keep quiet* about its business affairs so long as they stayed out of the market." *Deutschman* v. *Beneficial Corp.*, *supra*, 841 F.2d at 506 (emphasis added). The decision below in this case defines the circumstances in which that freedom "to keep quiet" may be abridged. The teachings of *Chiarella* and *Dirks* cannot be ignored in such context.

Whether A Private Right of Action For Aiding and Abetting A Violation of Section 10(b) Exists Is An Important Question Ripe for This Court's Review.

The Petition also raises an issue broader than that of the standards to be applied in an aiding and abetting claim premised on silence: whether an implied private right of action exists at all for aiding and abetting a violation of Section 10(b) or Rule 10b-5.

(a) Respondents suggest that, notwithstanding this Court's reservation of that question on two separate occasions, the question is not an important one requiring review (Br. Op. 10). We do not believe this Court bothers to reserve issues lacking in importance. The most comprehensive recent scholarly treatment of this subject, after analyzing the issue in terms of the tests this Court has applied, concludes that this Court's review of this "overarching question" is, at least absent explicit Congressional guidance, important to improve the proper application of the federal securities laws. Bromberg & Lowenfels, *Aiding and Abetting Securities Fraud: A Critical Examination*, 52 Albany L. Rev. 637, 773 (1988). The Petition presents an opportunity to decide this issue not by acquiescence in a series of lower court decisions originating before this Court developed its rigorous standards for implied rights of action,[2] but by affirmative consideration of the application of those standards to the statutory language and schema.

(b) Contrary to respondents' contention (Br. Op. 9), the broader point as to the existence of a private right of action was raised below and preserved for this Court's review. Since the district court had dismissed the complaint for failure to state a claim and the Ninth Circuit had previously recognized the existence of a private cause of action for aiding and abetting, there was no occasion to challenge this Ninth Circuit law until the court of appeals reversed the dismissal. Then, in its petition for

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2 The Ninth Circuit recognized a private right of action for aiding and abetting before this Court's decision in *Cort* v. *Ash*, 422 U.S. 66 (1975), established a framework for analysis.

rehearing, Peat Marwick explicitly referred to the fact that the "Supreme Court has expressly reserved judgment on whether 'civil liability for aiding and abetting is appropriate under [section 10(b) and Rule 10b-5]' ", citing this Court's decision in *Ernst & Ernst* v. *Hochfelder*, 425 U.S. 185 (1976), explicitly noting that this Court had recognized the question to be one of statutory construction and drawing the Ninth Circuit's attention to the leading critique of the recognition of such claim (Petition for Rehearing 6-7 n.6). Thus the question was raised and preserved. This question is, in any event, clearly a step on the path to determination of the elements of an aiding and abetting claim if any exists.

* * *

In this case the court of appeals held, as lower courts interpreting the decision have recognized, that a valid cause of action exists when the complaint alleged that "investors relied on Peat, Marwick's reputation when deciding to invest and that they would not have invested had Peat, Marwick disclosed the alleged fraud." 857 F.2d at 653 (Pet. 15a).[3] This flat acknowledgment of potential liability for a professional based not on any report or statement made by it, but on the use of the defendant's name and its failure to speak, when coupled with the Ninth Circuit's refusal to require, as other circuits have, that an independent duty to speak be present where a claim is asserted in such circumstances, represents an extension of existing law and poses a serious and important conflict among the Circuits. Such holding is also at variance with more general guidance from this Court in *Chiarella* and *Dirks*. The decision and the questions arising from it presented in the Petition warrant review.

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3 This is the interpretation of *Roberts* adopted in *In re Worlds of Wonder Securities Litigation*, [1989] Fed. Sec. L. Rep. (CCH) ¶ 94,449 at 92,888 (N.D. Cal. 1989) (to be officially reported at 721 F.Supp. 1140).

CONCLUSION

For the foregoing reasons and the reasons set forth in the Petition, Peat Marwick's petition for a writ of certiorari should be granted.

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Respectfully submitted,

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